No. 90-1

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

IN RE: PAN AM CORPORATION; PAN AMERICAN WORLD AIRWAYS, INC.; PAN AM SHUTTLE INC.; PAN AM EXPRESS, INC.; PAA CORP.; ALLMAT INTERNATIONAL, INC.; ALERT MANAGEMENT SYSTEMS, INC.; PAN AM COMMERCIAL SERVICES, INC., *Debtors in Possession-Petitioners*,

SECTION 1110 PARTIES; OMNIBUS SECTION 1110 PARTIES; PS GROUP, INC.; GRAND CENTRAL PARTNERS NO. 1; GRAND CENTRAL PARTNERS NO. 2; GRAND CENTRAL PARTNERS NO. 3; UNITED STATES AIRLEASE, INC.; CL AIRCRAFT VII, INC; C.I.T. LEASING CORPORATION; THE CIT GROUP/EQUIPMENT FINANCING, INC.; UNITED STATES TRUST COMPANY OF NEW YORK, as indenture trustee; NMB LEASE NV; ORIX CORPORATION; NISSHO IWAI CORPORATION; C. ITOH 7 CO., LTD;

(*Caption continued on inside cover*)

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Respondents-Respondents,

—v.—

PAN AM CORPORATION,

Debtor-Petitioner.

QUESTION PRESENTED

Whether the court below erred in ruling that section 1110 of the Bankruptcy Code, 11 U.S.C. § 1110, deprives airlines of the benefits of the automatic stay and other important protections of the Bankruptcy Code with respect to sale-leaseback transactions that simply provided financing based on an airline's existing fleet and did not add any aircraft to that fleet, thereby upsetting Congress' carefully crafted balancing of interests between the rights of creditors and the ability of air carriers to reorganize under chapter 11 of the Bankruptcy Code?

PARTIES TO THE PROCEEDING

The parties to this proceeding are identified in the caption.* In addition to these parties, America West Airlines, Inc., American Airlines, Inc., Northwest Airlines, Inc., USAir, Inc., Continental Airlines, Inc., and the American Association of Equipment Lessors participated in these proceedings before the United States Court of Appeals for the Second Circuit below as *amicus curiae*.

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* The following information is provided pursuant to Rule 29.1 of this Court: Pan Am Corporation is the direct or indirect corporate parent of each of the other Debtors in Possession-Petitioners. A complete list of the corporate affiliations of each of the Debtors in Possession-Petitioners can be found in the petitions for reorganization filed in the United States Bankruptcy Court for the Southern District of New York on January 8, 1991 (Chapter 11 Case Nos. 91 B 10080 (CB) through 91 B 10087 (CB)).

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

IN RE PAN AM CORPORATION ET AL.,

Debtors in Possession-Petitioners

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Debtors in Possession-Petitioners Pan Am Corporation, Pan American World Airways, Inc., Pan Am Shuttle Inc., Pan Am Express, Inc., PAA Corp, Allmat International, Inc., Alert Management Systems, Inc., Pan Am Commercial Services, Inc. ("Petitioners") respectfully pray that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, entered in this proceeding on April 2, 1991.

OPINIONS BELOW

The per curiam opinion of the Court of Appeals for the Second Circuit (App. A), Opinion and Order No. 67650 (App. B) of the District Court for the Southern District of New York, and the opinion (App. C) of the Bankruptcy Court for the Southern District of New York are currently unreported.

JURISDICTION

The judgment of the Court of Appeals for the Second Circuit was entered on April 2, 1991. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTE INVOLVED

This case involves section 1110 of chapter 11, title 11 of the United States Code (the "Bankruptcy Code"), 11 U.S.C. § 1110, which provides in relevant part that:

> (a) The right of a secured party with a purchase-money equipment security interest in, or of a lessor or conditional vendor of, whether as trustee or otherwise, aircraft, aircraft engines, propellers, appliances, or spare parts, as defined in section 101 of the Federal Aviation Act of 1958 (49 U.S.C. 1301) . . . that are subject to a purchase-money equipment security interest granted by, leased to, or conditionally sold to, a debtor that is an air carrier operating under a certificate of convenience and necessity issued by the Civil Aeronautics Board . . . to take possession of such equipment in compliance with the provisions of a purchase-money equipment security agreement, lease, or conditional sale contract, as the case may be, is not affected by section 362 or 363 of this title or by any power of the court to enjoin such taking of possession, unless—
>
> (1) before 60 days after the date of the order for relief under this chapter, the trustee, subject to the court's approval, agrees to perform all obligations of the debtor that become due on or after such date under such security agreement, lease, or conditional sale contract, as the case may be; and
>
> (2) any default, other than a default of a kind specified in section 365(b)(2) of this title, under such security agreement, lease, or conditional sale contract, as the case may be—

(A) that occurred before such date is cured before the expiration of such 60-day period; and

(B) that occurs after such date is cured before the later of—

(i) 30 days after the date of such default; and

(ii) the expiration of such 60-day period.

(b) The trustee and the secured party, lessor, or conditional vendor, as the case may be, whose right to take possession is protected under subsection (a) of this section may agree, subject to the court's approval, to extend the 60-day period specified in subsection (a)(1) of this section.

Section 1110 is an anomaly. The protection of the automatic stay provided by section 365 of the Bankruptcy Code, 11 U.S.C. § 365, which is central to the Bankruptcy Code's express purpose of promoting the reorganization of debtors, is compromised by section 1110's unique exception provided, in the case of airline reorganizations, to a narrowly defined group of financiers.

STATEMENT OF THE CASE

A. THE PROCEEDINGS BELOW

On January 8, 1991 (the "Petition Date") Pan Am Corporation, Pan American World Airways, Inc., Pan Am Express, Inc. and Pan Am Shuttle, Inc. (collectively "Debtors" or "Pan Am"), along with other affiliates of Pan Am Corporation, filed petitions for reorganization under chapter 11 of the Bankruptcy Code. On February 22, 1991, Pan Am brought on by order to show cause a motion seeking, *inter alia*, an order declaring that certain sale-leaseback transactions involving aircraft already in Pan Am's fleet at the time of the transactions were not covered by section 1110 (the "Section 1110 Motion"). On March 7, 1991, after a nonevidentiary hearing, the United States Bankruptcy Court for the Southern District of New York (Blackshear, J.) (the

"Bankruptcy Court") denied the Section 1110 Motion and Pan Am's motion for a stay pending appeal from the bench, and the next day issued an order incorporating its oral ruling.[1]

On March 8, 1991, the United States District Court for the Southern District of New York (Mukasey, J.) (the "District Court") denied Pan Am's request for a stay pending appeal of the Bankruptcy Court's order, but granted a request for an expedited appeal. On March 12, 1991, Pan Am appealed the denial of the stay and sought an order preserving the *status quo* from the United States Court of Appeals for the Second Circuit (the "Court of Appeals"). The Court of Appeals granted a stay of the Bankruptcy Court's order pending further hearing on the matter before the panel assigned to hear motions on Tuesday, March 19, 1991.

On the eve of that hearing, the District Court issued its ruling on Pan Am's appeal, affirming the Bankruptcy Court's denial of that part of the Section 1110 Motion which addressed the sale-leaseback issue. The District Court denied Pan Am's request for a stay pending appeal, but granted Pan Am's request under Fed. R. Civ. P. 54(b) to sever the ruling on the sale-leaseback issue from the other issue that remains on appeal.

On March 19, 1991, the Court of Appeals granted Pan Am a stay pending appeal of the District Court's order and an expedited appeal. Following a hearing on the merits on April 2, 1991, the Court of Appeals, in a per curiam opinion, affirmed the District Court decision and granted a further stay until noon, Friday, April 5, 1991 in order for Pan Am to seek a further stay from this Court. Pan Am now seeks to obtain review of the decision of the Court of Appeals by the Supreme Court of the United States.

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1 The Bankruptcy Court subsequently issued a written opinion, dated March 15, 1991.

B. THE DECISIONS BELOW

1. The Bankruptcy Court's Decision

The Bankruptcy Court held that a "plain and literal reading" of section 1110 called for "a nonrestrictive reading of the words lease and lessor" to include sale-leaseback transactions, although it recognized that this would impose extreme hardship on Pan Am. The Court also recognized that this reading of the statute gave the benefits of section 1110 to "parties to numerous Sale-Leasebacks in which the Debtors 'sold' Aircraft and Equipment which had been part of their fleet for many years to financiers, who then leased that same Aircraft and Equipment back to the Debtors."

The Court conceded that there was an apparent logical flaw in its interpretation: "PMESIs [purchase money equipment security interests] and conditional sales are created for the very purpose of financing the acquisition of equipment [while] a sale-leaseback, where the air carrier sells to the lessor an aircraft that has been part of the air carrier's fleet for a substantial period of time, is a creative means of infusing working capital into the air carrier's business. Therefore, to some, there seems to exist an inconsistency in the statute since it extends equal protection to transactions which, at first blush, do not serve the same purpose."

The Court also conceded that "[i]t is possible that Congress intended to extend section 1110's coverage to only those agreements relating to the new acquisition of equipment by an air carrier [and that] [t]he legislative history seems to suggest that section 1110 was intended to protect transactions involving the financing of new acquisitions of aircraft by a debtor."

The Court concluded, however, that the legislative history was not sufficiently clear to allow it to deviate from its view of the "plain meaning" of the statute. The Court argued, based on its reading of the legislative history of section 116(5) of the Bankruptcy Act, which was enacted in 1957 and which was one of the predecessor provisions of section 1110, that

Congress did not have a single clear legislative purpose. The Court's reading of the earlier legislative history suggested additional congressional concerns over "title" and with respect to increasing "the availability of capital [to air carriers] at a lower interest rate."[2]

The Court failed to consider the legislative history surrounding the amendment of section 77 of the Bankruptcy Act in 1935, which was the model for section 116(5). That legislative history makes clear the acquisition purpose of section 77(j) which was the very beginning of the historic development of section 1110. The Court thereby committed the same error as did the Florida Bankruptcy Court in its dicta in *In re Braniff, Inc.*, 110 B.R. 980 (Bankr. M.D. Fla. 1990), by failing to consider section 77(j) and by taking language in the legislative history of section 116(5) out of its historical and logical context.

The Court also failed to explain why, if Congress was concerned with concepts of title, it extended section 1110's reach in 1978 to holders of security interests in equipment where title belonged to the Debtor, or why, if Congress was concerned with increasing the availability of low-cost financing

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2 The Court stated that it drew support from the following language in the legislative history:

> Testimony before the Bankruptcy Subcommittee of this committee indicated that the smaller lines are presently unable *to attract the capital necessary for their current reequipment requirements*. Testimony also indicated that the enactment of this bill would result in an increased availability of capital and at a lower interest rate than would be demanded under present conditions. The reason for this is the greater security afforded conditional sales vendors and lessors by the amendment to Chapter X made in this bill.

H.R. Rep. No. 944, 85th Cong., 1st Sess. 1-2 (1957), *reprinted in* 1957 U.S. Code Cong. & Admin. News 1926 (the "1957 House Report") (emphasis added).

The 1957 House Report concludes as follows: "This would establish an exception similar to that now accorded to rolling stock of railroads under Section 77j. It is contemplated that the enactment of this bill will result in extensive use of equipment trust financing as the financial basis for a major reequipment program." *Id.* at 1927.

generally, it specifically excluded general mortgages from coverage under section 1110.[3]

The bottom line is that the Bankruptcy Court was reluctantly driven by its misapplication of the "plain meaning" rule to reach a harsh result for which it could muster no credible support in terms of logic or legislative history.

2. The District Court's Decision

The District Court produced on an expedited basis an opinion that like that of the Bankruptcy Court relies heavily on the "plain meaning rule."[4] After stating that "[o]n its face,

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3 Indeed, the 1978 House Report makes it perfectly clear that Congress did not think it was perpetuating the importance of "title," but was eliminating title as a requirement.

> An attempt was made to preserve the limitations on the right of the financier contained in current law. However, certain changes were made. First, the proposed sections provide protection for equipment security interests. The term includes only security interests that were granted to finance the acquisition of the covered equipment. A general mortgage is excluded. Under present law, the protection applies only to leases and conditional sales of equipment. The theory behind the present limitation is that under leases and conditional sales, title of the property does not pass to the debtor, but remains in the financier. Thus, it is appropriate to exclude what is not property of the estate from the automatic stay in a reorganization case.
>
> *Changes in financing practices and in the bankruptcy laws have suggested that the former limitation be deleted*, and that the protection be expanded to cover equipment security interests. . . . *Because retention of the prior limitation would unnecessarily force equipment financing transactions into outmoded forms, protection of security interests was added to make financing forms more flexible and more consonant with modern law.*

H.R. Rep. No. 595, 95th Cong., 1st Sess. 238-41 (1977), *reprinted in* 1978 U.S. Code Cong. & Admin. News 6199-6200 (the "1978 House Report") (emphasis added).

4 The Court disagreed with the opposite holding of the Bankruptcy Court in Delaware, which was presiding over the chapter 11 proceeding

the statute is unambiguous," the Court, however, in the very next sentence of its opinion proves, in truth and in fact, that this is not the case. It states "[t]o the extent a party is a *true* lessor and otherwise qualifies under the statute, it is entitled to the 'extraordinary protection of § 1110.' " (emphasis added). Of course the word "*true*" does not appear in the language of section 1110 but is a limitation on the words of the section that the Court believes is required by the legislative purpose as demonstrated by the language of the statute and its legislative history. The rest of the Court's opinion then surveys the true battleground for this appeal—how section 1110 should be interpreted in light of its legislative history and purpose.

The Court recognized the relevance of the legislative history of the amendment to section 77, enacted in 1935, conceding "[t]hat provision had been enacted '[i]n view of the necessity of readily financing purchases of new equipment at a time when the development of the transportation art is providing new forms of equipment.' " (citing H.R. Rep. No. 1283, 74th Cong., 1st Sess. 4 (1935)).

The Court also conceded that the legislative history of section 116(5) shows a congressional concern with the need of airlines to " 'replace obsolete equipment with modern aircraft.' " The Court concluded, however, based on the same misreading of the House Report as the Bankruptcy Court, that while "Congress may have had the ultimate end in 1957 of encouraging airlines to acquire new equipment, one means to that end incorporated in the statute was to increase the availability and decrease the cost to an airline of capital."

Not only is this interpretation of the legislative history not supported by a close reading of the House Report but it fails

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of *Continental Airlines, Inc.*, the nation's fifth largest airline. *In re Continental, Inc.*, Ch. 11 Case Nos. 90-932 through 90-980 (Bankr. D. Del. Jan. 30, 1991) (Balick, Bankr. J.). That decision was reversed on April 1, 1991 by the United States District Court for the District of Delaware in an opinion that has not yet been published (which we have submitted separately to the Court).

as a matter of logic. If Congress was seeking merely to make low-cost financing available to airlines, why did it limit the category of financiers and the types of collateral that were protected? Moreover, since even the District Court conceded that the ultimate purpose was to help carriers obtain new equipment, how could there be any assurance that the money raised would be used for new equipment rather than for some other purpose (such as to fund operating losses as was the case with Pan Am), if the protection of the statute was not limited to acquisition financing?

The Court then addressed the legislative history of 1978 Bankruptcy Code. It conceded that the history of section 1110 demonstrates with precision that "Congress refused to include [U.C.C.] Article 9 transactions within § 1110 unless they included an acquisition element [and that] Congress also demonstrated its intention in the clearest way it could, through the words it used, by limiting the statutory protection to a 'secured party with a *purchase-money* equipment security interest.' "

The Court found, however, that the same history "fails to show with any clarity that Congress also intended *to add* an acquisition element to lease transactions." (emphasis added). The Court's conclusion is therefore the result of a compounding of its erroneous interpretation of the prior law.

It also ascribes an almost capricious intent to Congress in enacting section 1110. The Court recognized that certain of the 1978 changes were motivated by a desire to have the provision apply to "financing forms more flexible and more consonant with modern law." The Court's conclusion, however, is that Congress for some unexplained reason intended that if a financier used these modern flexible security devices it was protected only if it engaged in acquisition financing, but if the financier could structure its financing to take advantage of older and generally obsolete financing forms, then it was protected for an advance of funds for any purpose whatsoever.

The Court attempted to justify its conclusion based on an analysis of the grammar of section 1110. Its determination, however, that "the acquisition element explicitly imposed on secured parties, and the acquisition element inherent in the status of conditional vendors, implies no such acquisition element with respect to lessors," simply flies in the face of history, logic and well accepted principles of statutory construction.[5]

Finally, the Court attempted to bolster its determination with policy arguments based on the virtue of sale-leaseback transactions, although it acknowledged that "[s]ale-leaseback transactions of the type and complexity in which Pan Am engaged may not have been directly contemplated at the time of the statute's enactment, nor explicitly mentioned in the legislative history." The Court's argument that sale-leaseback transactions may somehow lead to, or serve as a bridge for the acquisition of new and improved equipment, is not only unsupported, it is contradicted, by the record in this case. Sale-leasebacks of 20-year-old planes such as the financings at issue on this appeal did not result in new equipment for Pan Am, but necessarily required Pan Am to retain and to continue making rental payments on older equipment. They also removed the airline's incentives to upgrade equipment since any increased residual value would inure to the benefit of the sale-leaseback financier and not the airline.

The irony of these fanciful arguments in support of the "plain meaning" of the statute is that not only are they unsound, they find no support in the legislative history whatsoever. Indeed, if Congress wanted simply to promote generally affordable secured financing for airlines it could have simply provided that airlines were ineligible to file for chapter 11 (which may, in effect, be the practical result of the lower

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5 Aside from disregarding the legislative history of the 1935 and 1957 statutory predecessors of section 1110, the Court also failed to apply the principle of common sense construction known as the doctrine of "*noscitur a sociis*" which provides that the meaning of particular words of a statute may be ascertained by reference to the meaning of the words with which they are associated.

Court's decision); it would not have crafted a narrowly drawn provision such as section 1110 which continued the limitations Congress thought it placed in prior laws to encourage acquisition financing; and it certainly would not have admonished the courts to construe the provision narrowly to avoid a collision with other goals of the Bankruptcy Code.

3. The Court of Appeals's Decision

The Court of Appeals, in a per curiam opinion, affirmed the decision of the District Court "for substantially the reasons stated by Judge Mukasey."

REASONS FOR GRANTING THE WRIT

THE DECISIONS OF THE COURTS BELOW RAISE SIGNIFICANT QUESTIONS CONCERNING THE APPLICABILITY OF SECTION 1110 OF THE BANKRUPTCY CODE THAT HAVE NOT BEEN ADDRESSED PREVIOUSLY BY THIS COURT

A. THE SCOPE OF SECTION 1110 IS A MATTER OF NATIONAL IMPORTANCE

No provision of the 1978 Bankruptcy Code has greater significance for an airline's ability to reorganize than section 1110. Unless an airline is able to comply with its section 1110 obligations, it will not be able to retain certain of its most essential assets—its aircraft affected by section 1110—for more than sixty days after filing a petition. The expansive definition of section 1110 to include sale-leaseback transactions adopted by the courts below, effectively denies the benefits of chapter 11 to Pan Am and many other of the nation's sorely troubled airlines.

The irony of this expansive interpretation of section 1110 is that no one disputes that section 1110 is a provision through which Congress intended to help airlines; it was, moreover, enacted in the context of general bankruptcy reform designed

to improve the ability of companies, especially public companies, to reorganize. Neither can anyone dispute that now—perhaps more than at any point in this nation's aviation history—airlines desperately need the ability to use chapter 11 to reorganize.

Determination of the issue raised here is critical to the future of the airline industry because its resolution will determine the shape of the industry. Braniff, Eastern and certain small airlines are already gone. Pan Am, Continental Airlines, Midway Airlines and Metro Airlines are all now in chapter 11 and newspaper reports indicate that several other airlines (including T.W.A., Northwest and Hawaiian Air) may seek protection at any time. *See* Nomani, *TWA May Seek Chapter 11 Status, Even in Route Sale*, Wall St. J., Apr. 3, 1991, at A4, col. 3; *Bankruptcy Filing by Metro Airlines*, N.Y. Times, Apr. 2, 1991, at D5, col. 2; Pelline, *Airline Graveyards See Business Taking Off*, San Francisco Chronicle, Apr. 1, 1991, at B1; Poole, *Air Competition Running on Empty*, Chicago Tribune, Mar. 11, 1991, at 13; Greenberg, *The Savvy Traveler: Air Fares May Soar in Not-So-Friendly Skies*, L.A. Times, Mar. 10, 1991, at 2, col. 1; Ziemba, *U.S. Tailspin May Aid Foreign Airlines*, Chicago Tribune, Feb. 17, 1991, at C1; Joyner, *Northwest Asks Unions for Help*, Detroit News, Feb. 3, 1991, at E1; Gellene, *NWA Buys Stake in Hawaiian Air*, L.A. Times, Dec. 11, 1990, at D2, col. 3. Resolution of this issue may determine whether some or all of these carriers live or die.

The Court is unlikely to benefit from further review of this issue by the lower courts. A consensus has clearly developed contrary to the position we advocate on this appeal, including comprehensive opinions by district courts acting as appellate courts in the Second and Third Circuits. The Court of Appeals below obviously thought the issue was sufficiently settled that it did not even choose to write an opinion.

We respectfully submit that these decisions are desperately wrong and are based on a fundamental misinterpretation of some of this Court's recent pronouncements regarding courts'

role in construing statutes. In effect, the courts below, out of deference to blind literalism, have abandoned the traditional judicial function of interpreting statutes to effect Congress' purpose and a consistent and sensible public policy. Absent direction from this Court these decisions will almost certainly be followed. Should this Court delay reviewing this question, the harm to Pan Am and many other similarly situated airlines will simply not be able to be undone.

The scope of section 1110, a question never previously addressed by this Court, is therefore a matter of national importance. The impact of a decision on this issue militates in favor of granting review; the issue is "one of *general* importance [and not] 'in the mere interest of the litigants.' " Harlan, *Manning the Dikes*, 13 Rec. N.Y. City Bar Ass'n 541, 551 (1958) (quoting Chief Justice Hughes). The consequences not only to Pan Am, its approximately 25,000 employees, but also to tne entire airline industry, the finance industry and the traveling public, demonstrate the importance of this issue of federal law.[6]

B. THE READING OF SECTION 1110 BY THE COURTS BELOW PRODUCES ABSURD RESULTS, CONFLICTS WITH OTHER IMPORTANT GOALS OF THE BANKRUPTCY CODE, AND IGNORES CONGRESS' ADMONITION THAT SECTION 1110 SHOULD BE CONSTRUED NARROWLY

By refusing to read the term "lessor" consistently with Congress' intent, the courts below impermissibly transformed a carefully crafted statute designed to achieve a specific congressional purpose—the facilitation of financing of the acquisition of new equipment—into a wholly irrational statutory scheme that provides windfall benefits to sale-leaseback financiers at the expense of this nation's flagship air carrier and

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6 The acute interest of the airline and finance communities in this issue is shown by the Amicus Curiae briefs filed with the Court below, including one by the American Association of Equipment Lessors, which describes this issue as "of critical importance to the airline industry and to the equipment leasing industry."

other parties in interest in its chapter 11 proceeding. "Statutes should be interpreted to avoid untenable distinctions and unreasonable results whenever possible." *American Tobacco Co. v. Patterson*, 456 U.S. 63, 71 (1982). *See also Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 575 (1982) ("Interpretations of a statute which would produce absurd results are to be avoided if alternative interpretations consistent with the legislative purpose are available."); *United Sav. Ass'n v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 371 (1988) (in interpreting a provision of the Bankruptcy Code, "[s]tatutory construction is a holistic endeavor. A provision that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme—because the same terminology is used elsewhere in a context that makes its meaning clear . . ., or because only one of the permissible meanings produces a substantive effect that is compatible with the rest of the law") (citation omitted).

The legislative history of the 1978 Bankruptcy Code—consistent with congressional statements of intent with respect to leases and conditional sales dating back to the 1930s—states that security interests which do not arise from an acquisition transaction, *i.e.*, general mortgages, are excluded from section 1110. H.R. Rep. No. 595, 95th Cong., 1st Sess. 240 (1977), *reprinted in* 1978 U.S. Code Cong. & Admin. News 6199. The necessary, yet irrational, result of the interpretation of section 1110 adopted by the courts below is that nonacquisition sale-leaseback financiers are given vastly greater protection in the event of an airline bankruptcy than financiers with general mortgages, even though in both cases the financiers are providing working capital funds to the airline.

Neither the courts below, nor the financiers, have offered any reason grounded in the legislative history or otherwise—because none exists—as to why Congress would have wanted to favor so vastly sale-leasebacks over U.C.C. Article 9 financiers. To the contrary, as the legislative history of the statute indicates, Congress did *not* intend or envision this result, but instead intended to limit section 1110 to enumerated

acquisition financiers. For purposes of section 1110, nonacquisition sale-leasebacks and non-purchase money equipment security interests are substantively identical—both are nonacquisition transactions used to generate working capital funds—and the statute should not be distorted to treat these transactions differently.

Preferring one class of secured creditors over another in a manner that serves no enunciated congressional policy violates a fundamental principle of the Bankruptcy Code that similarly situated creditors are treated alike. *See* 5 *Collier on Bankruptcy*, ¶ 1123.01[4] (15th ed. 1990) (it is "a cardinal principle of bankruptcy law . . . that creditors of the same class have a right to equality of treatment"); *Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215, 219 (1941) (the "theme of the Bankruptcy Act is equality of distribution"); *Cunard S.S. Co. v. Salen Reefer Servs. AB*, 773 F.2d 452, 459 (2d Cir. 1985) ("[t]he guiding premise of the Bankruptcy Code, like its predecessor, the Bankruptcy Act, is the equality of distribution of assets among creditors").

The failure by the courts below to give a narrow construction to section 1110 also conflicts with one of the main purposes of the overall reform of the bankruptcy law when Congress enacted the Bankruptcy Code in 1978 which was to make chapter 11 more available for the reorganization of major public corporations. In interpreting the provisions of chapter 11, courts are required to recognize that "the policy of Chapter 11 is to permit successful rehabilitation of debtors." *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 527 (1984). Congress recognized that "[t]he fundamental purpose of reorganization is to prevent a debtor from going into liquidation, with an attendant loss of jobs and possible misuse of economic resources." *Id.* at 528 (citing H.R. Rep. No. 95-595 at 220 (1977)). "By permitting reorganization, Congress anticipated that the business would continue to provide jobs, to satisfy creditors' claims and to produce a return for its owners." *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 203 (1983). The automatic stay is central to the Bankruptcy Code's purpose of promoting the reorganization of a debtor:

> The automatic stay is one of the fundamental debtor protections provided by the bankruptcy laws. It gives the debtor a breathing spell from his creditors. It stops all collection efforts, all harassment, and all foreclosure actions. It permits the debtor to attempt a repayment or reorganization plan, or simply to be relieved of the financial pressures that drove him into bankruptcy.

In re Petrusch, 667 F.2d 297, 299 (2d Cir. 1981) (*per curiam*), *application denied*, 456 U.S. 911, *cert. denied*, 456 U.S. 974 (1982) (quoting the legislative history to the 1978 Bankruptcy Reform Act, H.R. Rep. 95-595, 95th Cong., 2d Sess. 340, *reprinted in* 1978 U.S. Cong. & Admin. News 6135, 6296-97). *See also In re Parr Meadows Racing Ass'n*, 880 F.2d 1540, 1545 (2d Cir. 1989), *cert. denied*, 110 S. Ct. 869 (1990).

Section 1110 stands in sharp contrast to this rehabilitative regime because it imposes an extremely onerous burden on an airline debtor—a mere sixty days into its reorganization, the airline is required to cure all prepetition defaults and most postpetition defaults relating to its most important physical assets, its aircraft, or it loses the benefit of the automatic stay. In short, section 1110 runs directly counter to the fundamental premise of the Code to provide breathing room to the debtor at the early stages in the bankruptcy proceeding, allowing the debtor time to reorganize. *In re Ionosphere Clubs, Inc.*, 922 F.2d 984, 989 (2d Cir. 1990). As stated by commentators:

> [Section 1110 is a] detriment for other creditors, in that assets—either the aircraft or cash—are removed from the debtor's estate and are not available during the reorganization process. This may harm the debtor's cash flow or interfere with its operations during the critical period following the commencement of a chapter 11 case, when the debtor's business is typically in its most precarious state. In addition, to the extent that the aircraft financier thereby receives more (because it takes its full contract rate of payment during reorganization) than it otherwise would (for example, where all other

> secured creditors accept a reduced or stretched out payment in a plan of reorganization), the special provisions result in a net loss to the estate and to other creditors.

Gerstell & Hoff-Patrinos, *Aviation Financing Problems Under Section 1110 of the Bankruptcy Code*, 61 Am. Bankr. L.J. 1, 4 (1987).[7]

In recognition of the need to maintain a balance between the benefits provided certain financiers and the detriment to the reorganizing entity and its other constituencies, both the Senate and House sponsors of the Bankruptcy Reform Act admonished courts that section 1110 is to be narrowly construed. 124 Cong. Rec. H11,102 (Sept. 28, 1978); S17,419 (Oct. 6, 1978), *reprinted in* 1978 U.S. Code Cong. & Admin. News 6471, 6540. The District Court wrongly ignored this congressional admonition, stating that "the value of statements in the Congressional Record as barometers of legislative intent is minimal at best." This Court, however, has held that the statements of the congressional sponsors of a bill are entitled to considerable deference. *Regents of Univ. of Calif. v. Public Employment Relations Bd.*, 485 U.S. 589, 595-97 (1988); *North Haven Bd. of Educ. v. Bell*, 456 U.S. 512, 526-27 (1982).

Construing section 1110 narrowly, it is clear that it cannot encompass nonacquisition sale-leasebacks. In enacting section 1110, Congress did not intend to favor sale-leaseback financiers over other secured parties who provided nonacquisition

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7 In addition to overriding the automatic stay for the protected class of creditors, the application of section 1110 frees a qualifying creditor from its normal burden of establishing a lack of adequate protection. Section 1110 instead requires that, early on in its reorganization efforts, the debtor must cure defaults or risk losing the equipment, regardless of whether that creditor is otherwise adequately protected. As a result, section 1110 in effect enables a qualifying lender to receive use and occupancy payments in excess of fair market value to the extent its contract rate exceeds the market rate.

financing.[8] Congress also did not intend to make chapter 11 effectively unavailable for the airline industry.

C. CONGRESS' PURPOSE IN ENACTING SECTION 1110 WAS TO FACILITATE AN AIRLINE'S ACQUISITION OF NEW EQUIPMENT AND NOT TO BENEFIT FINANCIERS OF AN AIRLINE'S EXISTING FLEET

1. The Term "Lessor" In Section 1110 Does Not Have A Well Understood Plain Meaning

Whether the "words of a statute are clear is itself not always clear." *United States v. Bonanno Organized Crime Family*, 879 F. 2d 20, 22 (2d Cir. 1989). The term "lease" is inherently ambiguous because it can refer to a variety of arrangements, including "tax leases," "accounting leases" and, for purposes relevant here, economic transactions that produce working capital financing as well as transactions which result in the acquisition of new equipment. The courts below held that yet an additional subcategory of financing leases, those that are not "true" leases, are not covered by section 1110. This holding necessarily defeats any arguments that the rulings below provided any certainty for the financial markets, and also belies any argument that the unadorned statutory words are clear.

As the term is used in section 1110 this ambiguity is pronounced because the term "lessor" is grouped with the words "conditional vendor" and "purchase money equipment security interest," both terms having a single meaning relating solely to new acquisitions. To determine whether the term "lessor" was intended by Congress to include sale-leaseback financiers, the Court must look to the statute as a whole, *Crandon v. United States*, 110 S. Ct. 997, 1001 (1990), and endeavor to interpret the term "lessor" in light of, and consistently with, the other related terms in the statute. *United*

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8 There is a logic to preferring acquisition financiers over other creditors, including other secured creditors, because they force an airline to increase its asset base commensurate with its new obligations. No other creditor is therefore prejudiced by favoring this type of financing.

States v. American Trucking Ass'ns, 310 U.S. 534, 545 (1940) ("[A word] takes color from its surroundings and frequently is carefully defined by the statute where it appears."). This principle of common sense construction is known as the doctrine of "*noscitur a sociis*," which provides that the meaning of particular words of a statute may be ascertained by reference to the meaning of words with which they are associated. *See, e.g., Dole v. United Steelworkers of Am.*, 110 S.Ct. 929, 935 (1990); *Massachusetts v. Morash*, 490 U.S. 107, 114-15 (1989); *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41, 51 (1987); *California v. Brown*, 479 U.S. 538, 543 (1987); *Garcia v. United States*, 469 U.S. 70 (1984); *National Muffler Dealers Ass'n v. United States*, 440 U.S. 472 (1979); *Third Nat'l Bank v. Impac., Ltd.*, 432 U.S. 312, 322 (1977); *Jarecki v. G.D. Searle & Co.*, 367 U.S. 303 (1961).

Where, as here, "the scope of a statutory provision is not made crystal clear by the language of the provision," *Berger v. Heckler*, 771 F.2d 1556, 1557 (2d Cir. 1985), the Court must look to the legislative history to " 'find that interpretation which can most fairly be said to be embedded in the statute, in the sense of being most harmonious with its scheme and with the general purposes that Congress manifested.' " *Commissioner v. Engle*, 464 U.S. 206, 217 (1984) (quoting *NLRB v. Lion Oil Co.*, 352 U.S. 282, 297 (1957) (Frankfurter, J., concurring in part and dissenting in part)).

Moreover, even if a statute is unambiguous on its face (which Pan Am submits is decidedly not the case here) a court must still look to the statute's purpose as reflected in the legislative history. As this Court has explained:

> When [the plain] meaning has led to absurd or futile results, however, this Court has looked beyond the words to the purpose of the act. Frequently, however, even when the plain meaning did not produce absurd results but merely an unreasonable one "plainly at variance with the policy of the legislation as a whole" this Court has followed that purpose rather than the literal words. *When aid to construction of the meaning of*

> *words, as used in the statute, is available, there certainly can be no 'rule of law' which forbids its use, however clear the words may appear on "superficial examination."*

American Trucking Ass'ns, 310 U.S. at 543-44 (emphasis added).

As shown herein, an analysis of the history of section 1110 refutes the "plain meaning" ascribed to it by the courts below. That history shows that the word "lease" was introduced in a predecessor statute in 1935, in contemplation of equipment trust financing arrangements and it was this acquisition concept that was carried forward in subsequent enactments. Congress sought to validate an arrangement that was used to permit the financing of new equipment free from the restrictions of after-acquired property clauses in existing indentures. The vehicle for accomplishing this was not, in fact, a "true lease." Moreover, a sale-leaseback was inherently incapable of accomplishing this goal.

In stark contrast to the conclusion of the courts below, the participants in nonacquisition sale-leasebacks in the airline industry have recognized for years the ambiguity in section 1110 with respect to whether it encompassed sale-leasebacks. Numerous articles in trade and legal journals have alerted practitioners that the applicability of section 1110 to sale-leasebacks was, at best, unclear. *See, e.g.*, Goldman, Album & Ward, *Repossessing the Spirit of St. Louis: Expanding the Protection of Sections 1110 and 1168 of the Bankruptcy Code*, 41 Bus. Law. 29, 53-54 (1985) (concluding that section 1110 does not encompass nonacquisition sale-leasebacks). As two commentators poignantly noted, section 1110 is "not without its ambiguities . . . its complexity sometimes fosters confusion and obscures the purpose that Congress intended. . . . The section is not a model of statutory drafting. Its flaws are both syntactical and logical." Giddens and Schick, *Section 1110 of the Bankruptcy Code: Time for Refueling?*, 6 Am. Bankr. L.J. 109, 111, 131 (1990).

Evidence that section 1110 did not have a plainly understood meaning is further provided by 1933 Securities Act prospectuses containing public disclosure concerning the applicability of section 1110 of the Bankruptcy Code. For example, one such prospectus stated

> [t]here are few cases interpreting section 1110, and certain writers believe that it is not clear whether section 1110 applies to a transaction involving aircraft equipment already owned by a certified airline, or whether it applies only to transactions involving new equipment or equipment 'new' to the airline. . . . [T]he Partnership may acquire and lease Aircraft which are already owned by airlines in 'sale-leaseback' transactions, and may not under such circumstances be entitled to the benefits of section 1110.

Polaris Aircraft Income Fund IV, Prospectus at 46-47 (Oct. 15, 1987).

2. The Legislative History Of Section 1110 And Its Predecessor Provisions Clearly Demonstrates Congress' Purpose To Facilitate The Acquisition Of New Equipment By Airlines

Congress has consistently made it clear that section 1110 was designed to encourage the availability of financing for the acquisition of new equipment and, accordingly, limited its applicability to the types of acquisition financings prominent in the industry. *See generally* Goldman, Album & Ward, *supra*, at 38-39. Section 1110's historical roots are traceable to the 1935 enactment of section 77(j) of the old Bankruptcy Act.[9] This amendment created limited bankruptcy exceptions in railroad reorganization cases designed to benefit certain transactions then used for acquisition financing in the railroad industry. Congress has since extended these protections twice to other industries (the airline industry in 1957 and the

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9 *See* 5 King, *Collier on Bankruptcy*, ¶ 1110.01, at 1110-3 (15th ed. 1990) ("Sections 1110 and 1168 should be compared with Sections 77(j), 116(5) and 116(6) of the Bankruptcy Act . . . .").

water carrier industry in 1968) and preserved and modernized the provision when it enacted the 1978 Bankruptcy Code. The common thread running through all of these congressional enactments, as reflected in both the language of the statutes and legislative history, is that the section was designed to encourage investment in new equipment to airlines—not to provide windfall benefits to financiers who, like the sale-leaseback financiers, merely provide working capital funds to airlines.

a. The 1935 Amendment To Section 77 Of The Bankruptcy Act Provided An Exception For The Common Acquisition Financing Transactions Of That Period

In the 1930s, the two primary forms of acquisition financings in the railroad industry were conditional sales and leases. These financing mechanisms developed as a means of avoiding the effect of after-acquired property clauses, which provided that property acquired by the borrower subsequent to the granting of a general mortgage become subject to that preexisting mortgage. Since conditional sales and leases allowed title to remain with the acquisition financier rather than passing to the railroad, the rolling stock would not be subject to the after-acquired property clause. *See generally* 2 Gilmore, *Security Interests in Personal Property*, § 28.2 (1965). As emphasized by Professor Gilmore, only transactions that promoted the acquisition of property, however, were protected from an after-acquired property clause contained in preexisting liens. *Id.* at 750 ("To rank as purchase money, a claim must be, it was often said, 'directly' related to the acquisition of property."). Not only were sale-leasebacks not in general use at that time but they would not have served the purpose of escaping an after-acquired property clause. Property already subject to such clauses would not be newly financeable by a sale-leaseback transaction because the proceeds from the sale portion of the transaction would be required to be applied to the preexisting debt.

In the wake of the Great Depression, Congress amended section 77 of the Bankruptcy Act to facilitate railroads' ability to re-equip themselves with modern equipment. Prior to that amendment, section 77 had permitted federal courts to stay any suit affecting a railroad organization, and courts were empowered to prevent conditional sellers or lessors of rolling stock from repossessing that rolling stock from a railroad in reorganization. To remedy that situation, and thereby encourage acquisition financings, Congress provided that the conditional sales and leases would receive special protections in bankruptcy.

Thus, amended section 77(j) provided in relevant part that:

> The title of any owner, whether as trustee or otherwise, to rolling-stock equipment leased or conditionally sold to the debtor, and any such right of such owner to take possession of such property in compliance with the provisions of any such lease or conditional sale contract, shall not be affected by the provisions of this section.

41 Stat., 74th Cong., 1st Sess. § 77(j) at 922 (1935). Because at that time the means by which acquisition financiers escaped the effects of an after-acquired property clause depended on the financiers' retention of title in the equipment, the statute provided that the Bankruptcy Act affected neither the acquisition financier's title nor its right to take possession of the property.

The House Report accompanying the statute makes it absolutely clear that the section was intended to benefit only acquisition financiers:

> Under the present provisions of section 77, there is doubt whether the trustee under the typical equipment-trust agreement is entitled to the possession of the property insured by the terms of the agreements, it having been urged in some of the pending cases that, under the provisions of section 77, the equipment-trust arrangement must be treated as an ordinary mortgage. *If this were done, the investors in the trusts would, conse-*

> *quently, be deprived of the preference intended to be preserved to them by the terms of the agreements, which in form and substance are generally in the nature of contracts of conditional sale. In view of the necessity of readily financing purchases of equipment at a time when the development of the transportation art is providing new forms of equipment*, particularly in the passenger field, of which, in interests of efficiency and economy, the carriers should be able to avail themselves, *and because after a depression the carriers are usually required to make large expenditures for equipment* in order to accommodate the improved traffic, your committee is of the opinion that any doubt should be removed with reference to the validity of the equipment trust *as a means of financing equipment purchases*. Consequently H.R. 8507 carries an amendment in subsection (j) under which the title of any owner to equipment leased or conditionally sold to the debtor, and any right of such owner to take possession of such property, shall not be adversely affected by the provisions of the section.

H.R. Rep. No. 1283, 74th Cong., 1st Sess. 4 (1935) (the "1935 House Report") (emphasis added).

As Justice Cardozo wrote: The words "came into the statute . . . freighted with the meaning imparted to them by the mischief to be remedied." *Duparquet Huot & Moneuse Co. v. Evans*, 297 U.S. 216, 220-21 (1936). In section 77(j), the "mischief to be remedied" was the difficulty faced by railroads in financing new acquisitions of equipment following the depression. Accordingly, "[i]n view of the necessity of readily financing purchases of equipment," the statute was designed to remove any doubt as to the validity of the equipment trust as a means of financing equipment purchases, and thus to ensure that equipment acquisition financiers would receive the priority to which they were entitled and would be entitled to repossess their equipment in the event of the railroad's bankruptcy. *Zirn v. Hanover Bank*, 215 F.2d 63, 68-69 (2d Cir. 1954) (rejecting argument that approval of the

Interstate Commerce Commission was required before repossession because such a requirement would prevent railroads from "procur[ing] needed equipment"). As stated by Judge Henry J. Friendly, this section was added in 1935 "because of the present and prospective needs of the railroads for large quantities of new type cars and motor power to replace obsolescent equipment." Friendly, *Amendment of Railroad Reorganization Act*, 36 Colum. L. Rev. 27, 43 (1936).

b. The 1957 Airline Legislation

In 1957, Congress enacted section 116(5), the predecessor to section 1110, affording to financiers of new equipment for air carriers the same protection it had previously afforded to financiers of new railroad equipment.[10] The House Report emphasized that, as with the previous railroad legislation, Congress' intent was to provide special benefits in bankruptcy to acquisition financiers:

> Many of the Nation's smaller airlines are today facing serious financing problems resulting from *the need to replace obsolete equipment with modern aircraft*. Only in this way can these lines properly meet the heavy

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10 Section 116(5) provided:

> Notwithstanding any other provisions of chapter X, the title of any owner, whether as trustee or otherwise, to aircraft, aircraft engines, propellers, appliances, and spare parts (as any of such are defined in the Civil Aeronautics Act of 1938, as now in effect or hereafter amended) leased, subleased, or conditionally sold to any air carrier which is operating pursuant to a certificate of convenience and necessity issued by the Civil Aeronautics Board, and any right of such owner or of any other lessor to such air carrier to take possession of any such property in compliance with the provisions of such lease or conditional sale contract shall not be affected by the provisions of Chapter X if the terms of such lease or conditional sale so provide.

Just as with the railroad legislation, because the retention of title was at that time fundamental to an acquisition financiers' ability to escape a prior lien's after-acquired property clause, the statute provided that the Bankruptcy Act did not affect the financiers' right to title or to repossess the property.

> demands of increased air travel and at the same time attain a sound financial condition which would obviate the need for continued subsidy.

H.R. Rep. No. 944, 85th Cong., 1st Sess. 1, *reprinted in* 1957 U.S. Code Cong. & Admin. News 1926 (emphasis added) (the "1957 House Report"). Congress hoped to facilitate air carriers' acquisition of new equipment by making it easier for them to obtain conditional sales and leases—again, the types of acquisition financing prevalent at that time. Thus, the 1957 House Report further stated that:

> Testimony before the Bankruptcy Subcommittee of this committee indicated that the smaller lines are presently unable to attract the capital necessary for their *current reequipment requirements.* Testimony also indicated that the enactment of this bill would result in an increased availability of capital and at a lower interest rate than would be demanded under present conditions. The reason for this is the greater security afforded conditional sales vendors and lessors by the amendment to chapter X made in this bill.

Id. at 1926 (emphasis added).

The 1957 House Report concluded by noting that:

> [I]n the event of default, the right of these creditors to take possession would be preserved. *This would establish an exception similar to that now accorded to rolling stock of railroads under section 77j. It is contemplated that the enactment of this bill will result in extensive use of equipment trust financing as the financial basis for a major reequipment program.*

Id. at 1927 (emphasis added). Significantly, there is nothing whatsoever in the legislative history of section 116(5) indicating that Congress ever intended to provide that section's benefits to financing parties who merely enabled the air carrier to obtain general working capital funds, such as sale-leaseback financiers, as opposed to financiers who directly financed the airline's acquisition of new equipment.

Nonetheless, the courts below relied on one sentence drawn out of context from the 1957 House Report to reach the strained conclusion that section 116(5) was broadly designed to increase the availability of capital to airlines in general. The entire House Report and even the paragraph from which that sentence was wrested, however, make it clear that the "capital" referred to in the quoted sentence is the "capital necessary for [airlines'] current reequipment requirements," not the working capital provided by sale-leasebacks. 1957 House Report at 1926. Moreover, the sentence relied on clearly is referring to "interest" being charged pursuant to an equipment trust arrangement, and not rent, which would be associated with a lease. In short, the 1957 legislation for airlines, like the 1935 legislation for railroads, was designed to provide special benefits in bankruptcy solely to acquisition financiers to encourage them to finance new equipment.

c. In The 1978 Legislation Enacting Section 1110 Congress Preserved And Reemphasized The Existing Limitation That The Statute Was Only Applicable To Acquisition Transactions

When Congress enacted the Bankruptcy Code in 1978, it carried forward and amended section 116(5) of the Bankruptcy Act, recodifying it as section 1110. Section 1110 contained several changes from prior law. First, the intent of the parties as expressed in their financing documentation and the possession of title by the financier were both eliminated from the new section as requirements for coverage. Second, a limitation was placed on the jurisdictional power of the Bankruptcy Court to extend the cure period beyond sixty days—for the first time giving sharp teeth to the provision.[11]

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11 Although sections 77(j) and 115(6) would appear to have been more favorable to financiers than section 1110, in practice courts often used their equitable powers to override those sections and to enjoin financiers from repossessing collateral. *See, e.g., In re Penn Cent. Transp. Co.*, 402 F. Supp. 127 (E.D. Pa. 1975); *In re Erie Lackawanna Ry.*, No. 75-2446 (N.D. Ohio 1975) (unreported decision). Numerous commentators have concluded that section 1110 was devised to provide

Finally, purchase money equipment security interests were included within the coverage of the provision in order to make the statute available for more modern and flexible security devices. The 1977 House Report spells out the rationale for these changes:

> *An attempt was made to preserve the limitations on the right of the financier contained in current law.* However, certain changes were made. First, the proposed sections provide protection for equipment security interests. *The term includes only security interests that were granted to finance the acquisition of the covered equipment. A general mortgage is excluded.* Under present law, the protection applies only to leases and conditional sales of equipment. The theory behind the present limitation is that under leases and conditional sales, title of the property does not pass to the debtor but remains in the financier. Thus, it is appropriate to exclude what is not property of the estate from the automatic stay in a reorganization case.
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> Changes in financing practices and in the bankruptcy laws have suggested that the former limitation be deleted, and that the protection be expanded to cover equipment security interests. Since the adoption of the original sections, there has been universal adoption of Article 9 of the Uniform Commercial Code, which abolishes conditional sale contracts, and substitutes security agreements and security interests instead. Changes in the bankruptcy laws provide similar restraints for lessors of property to the debtor as exist for mortgages or secured creditors, Indeed, the Uniform Commercial Code acknowledges that some leases are merely disguised secu-

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greater guarantees to equipment financiers of their repossession rights, by providing that those rights were not affected by the automatic stay or by the court's equitable powers to issue injunctions. *See* Giddens & Schick, *supra* at 118; Goldman, Album & Ward, *supra*, at 42 (1985); 5 King, *Collier on Bankruptcy* ¶ 1110.01[6][c], at 1110-23 (15th ed. 1990).

> rity agreements, and directs that they be so treated. Because retention of the prior limitation would unnecessarily force equipment financing transactions into outmoded forms, protection of security interests was added to make financing forms more flexible and more consonant with modern law.

H.R. Rep. No. 595, 95th Cong., 1st Sess. 238-41 (1977), *reprinted in* 1978 U.S. Code Cong. & Admin. News 6199-6200 (emphasis added). Similarly, the 1978 Senate Report emphasized that the legislation was intended to "preserve[ ] the protection" previously afforded to "lessors and conditional vendors"—not to expand them. S. Rep. No. 989, 95th Cong., 2d Sess. 116, *reprinted in* 1978 U.S. Code Cong. & Admin. News 5902 (the "1978 Senate Report").

* * *

Accordingly, the legislative history is crystal clear that Congress never intended to provide special protection to anything other than acquisition financing. Moreover, Congress also expressed a consistent intent to avoid wholly depriving airlines of the benefits of reorganization proceedings by excluding general mortgages (which could affect a substantial portion of an existing fleet).

Congress did not anticipate the advent of a tremendous volume of sales-leaseback financing. Nor did Congress anticipate that sale-leaseback financiers would argue for an interpretation of section 1110 that would thoroughly undermine its careful balancing of interests. Congress' failure to draft section 1110 to deal more clearly with problems it did not expect cannot, however, justify a result that is clearly contrary to what Congress intended.

It is the traditional and proper role of courts to interpret statutes to effectuate the will of the Congress and to achieve a sensible public policy. In the words of Judge Learned Hand

> it is one of the surest indexes of a mature and developed jurisprudence not to make a fortress out of a dictionary; but to remember that statutes always have some purpose

> or object to accomplish, whose sympathetic and imaginative discovery is the surest guide to their meaning.

Cabell v. Markham, 148 F.2d 737, 739 (2d Cir.), *aff'd*, 326 U.S. 404 (1945).

CONCLUSION

For the foregoing reasons, the requested Writ of Certiorari should issue.

Dated: April 4, 1991

Respectfully submitted,

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APPENDICES

APPENDIX A

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Docket No. 91-5023

Filed April 2, 1991

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the 2nd day of April one thousand nine hundred and ninety-one.

Present: HON. J. EDWARD LUMBARD,
HON. RALPH K. WINTER,
HON. JOHN M. WALKER, JR.,
Circuit Judges,

IN RE: PAN AMERICAN CORPORATION; PAN AMERICAN WORLD AIRWAYS, INC.: PAN AMERICAN SHUTTLE, INCORPORATED; PAN AM EXPRESS; PAA CORPORATION; ALLMAT INTERNATIONAL INCORPORATED; ALERT MANAGEMENT SYSTEMS, INCORPORATED; PAN AMERICAN COMMERCIAL SERVICES, INCORPORATED,

Debtor,

SECTION 1110 PARTIES; OMNIBUS SECTION 1110 PARTIES; PS GROUP, INC.; GRAND CENTRAL PARTNERS NO. 1; GRAND CENTRAL PARTNERS NO. 2; GRAND CENTRAL PARTNERS NO. 3; UNITED STATES AIRLEASE, INC.; CL AIRCRAFT VII, INC; C.I.T. LEASING CORPORATION; THE CIT GROUP/EQUIPMENT FINANCING, INC.; UNITED STATES TRUST COMPANY OF NEW YORK, as indenture trustee; NMB LEASE NV; ORIX CORPORATION; NISSHO

IWAI CORPORATION; C. ITOH 7 CO., LTD; CITIBANK, N.A.; CITICORP NORTH AMERICA, INC., formerly doing business as Citicorp Industrial Credit, Inc.; DE NATIONALE INVESTERINGSBANK N.V.; GREYHOUND FINANCIAL CORPORATION; PK FINANS INTERNATIONAL CORPORATION; WESTINGHOUSE CREDIT CORPORATION; AERON AVIATION CORPORATION; IBJ SCHROEDER LEASING CORPORATION; U.S. CONCORD, INC.; LDI FINANCIAL SERVICERS CORPORATION; PLC LEASING CORPORATION; PROGRESS LEASING CORPORATION; BRITISH AEROSPACE, INC.; JET ACCEPTANCE CORPORATION; ROLLS ROYCE CREDIT CORPORATION; ROLLS ROYCE HOLDINGS, INC.: AVIONS DE TRANSPORT REGIONAL G.I.E., on behalf of itself and Wilmington Trust Company; NEW ENGLAND MERCHANT LEASING CORPORATION; MANHATTAN BAIL, G.I.E.; THE CONNECTICUT NATIONAL BANK; WESTINGHOUSE CREDIT CORPORATION; MANHATTAN LEASE, G.I.E.; CHRYSLER CAPITAL CORPORATION; BARCLAYS BANK; THE CONNECTICUT NATIONAL BANK AND TRUST COMPANY, N.A.; PACIFIC HARBOR CAPITAL INC.; G.M. AVIATION SERVICES S.A.; UNIBANK A/S, NEW YORK BRANCH; INTEGRATED AIRCRAFT CORPORATION; NATIONAL WESTMINSTER BANK; INTEGRATED AIRCRAFT CORPORATION; AERONAUTICS FOUR-SEVEN A, INC.; AERONAUTICS I, INC.; THE BANK OF NEW YORK, as Trustee; EVERGREEN INTERNATIONAL AIRLINES, INC.; EVERGREEN VENTURE, INC.; COBBLESTONE CORPORATION; WILMINGTON TRUST COMPANY; GENERAL ELECTRIC CAPITAL CORPORATION; OFFICIAL UNSECURED CREDITORS COMMITTEE; UNITED AVIATION SERVICES; WELLS FARGO BANK NATIONAL ASSOCIATION,

Respondents-Appellees,

—v.—

PAN AMERICAN CORPORATION,

Debtor-Appellant.

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged and decreed that the judgment of said District Court be and it hereby is affirmed in accordance with the opinion of this court.

Further ordered that the stay pending appeal will be extended until noon, April 5, 1991, in order to allow appellants to seek temporary relief from the Supreme Court. It shall thereafter expire.

Elaine B. Goldsmith,
Clerk

/s/ EDWARD J. GUARDARO
by: Edward J. Guardaro,
Deputy Clerk

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 1519—August Term, 1990

(Argued: April 2, 1991 Decided: April 2, 1991)

Docket No. 91-5023

IN RE: PAN AMERICAN CORPORATION; PAN AMERICAN WORLD AIRWAYS, INC.; PAN AMERICAN SHUTTLE, INCORPORATED; PAN AM EXPRESS; PAA CORPORATION; ALLMAT INTERNATIONAL, INCORPORATED; ALERT MANAGEMENT SYSTEMS, INCORPORATED; PAN AMERICAN COMMERCIAL SERVICES, INCORPORATED,

Debtor,

SECTION 1110 PARTIES; OMNIBUS SECTION 1110 PARTIES; PS GROUP, INC.; GRAND CENTRAL PARTNERS NO. 1; GRAND CENTRAL PARTNERS NO. 2; GRAND CENTRAL PARTNERS NO. 3; UNITED STATES AIRLEASE, INC.; CL AIRCRAFT VII, INC; C.I.T. LEASING CORPORATION; THE CIT GROUP/EQUIPMENT FINANCING, INC.; UNITED STATES TRUST COMPANY OF NEW YORK, as indenture trustee; NMB LEASE NV; ORIX CORPORATION; NISSHO IWAI CORPORATION; C. ITOH 7 CO., LTD; CITIBANK, N.A.; CITICORP NORTH AMERICA, INC., formerly doing business as Citicorp Industrial Credit, Inc.; DE NATIONALE INVESTERINGSBANK N.V.; GREYHOUND FINANCIAL CORPORATION; PK FINANS INTERNATIONAL CORPORATION; WESTINGHOUSE CREDIT CORPORATION; AERON AVIATION CORPORATION; IBJ SCHROEDER LEASING CORPORATION; U.S. CONCORD, INC.; LDI FINANCIAL SERVICERS CORPORATION; PLC LEASING CORPORATION; PROGRESS LEASING CORPORATION; BRITISH AEROSPACE, INC.; JET ACCEPTANCE CORPORATION; ROLLS ROYCE CREDIT CORPORATION; ROLLS

ROYCE HOLDINGS, INC.; AVIONS DE TRANSPORT REGIONAL G.I.E., on behalf of itself and Wilmington Trust Company; NEW ENGLAND MERCHANT LEASING CORPORATION; MANHATTAN BAIL, G.I.E.; THE CONNECTICUT NATIONAL BANK; WESTINGHOUSE CREDIT CORPORATION; MANHATTAN LEASE, G.I.E.; CHRYSLER CAPITAL CORPORATION; BARCLAYS BANK; THE CONNECTICUT NATIONAL BANK AND TRUST COMPANY, N.A.; PACIFIC HARBOR CAPITAL INC.; G.M. AVIATION SERVICES S.A.; UNIBANK A/S, NEW YORK BRANCH; INTEGRATED AIRCRAFT CORPORATION; NATIONAL WESTMINSTER BANK; INTEGRATED AIRCRAFT CORPORATION; AERONAUTICS FOUR-SEVEN A, INC.; AERONAUTICS I, INC.; THE BANK OF NEW YORK, as Trustee; EVERGREEN INTERNATIONAL AIRLINES, INC.; EVERGREEN VENTURE, INC.; COBBLESTONE CORPORATION; WILMINGTON TRUST COMPANY; GENERAL ELECTRIC CAPITAL CORPORATION; OFFICIAL UNSECURED CREDITORS COMMITTEE; UNITED AVIATION SERVICES; WELLS FARGO BANK NATIONAL ASSOCIATION,

Respondents-Appellees,

—v.—

PAN AMERICAN CORPORATION,

Debtor-Appellant.

Before:

LUMBARD, WINTER, and WALKER,

Circuit Judges.

Appeal from a judgment of the United States District Court for the Southern District of New York (Michael B. Mukasey, *Judge*) affirming the bankruptcy court's ruling that lessors' actions to recover airplanes and equipment leased to Pan Am pursuant to certain sale-leaseback transactions may

be exempted from the automatic stay by operation of Section 1110 of the Bankruptcy Code.

Affirmed.

JEROME E. HYMAN, New York, New York (Thomas J. Moloney, Robert P. Davis, Howard S. Zelbō, James L. Bromley, Shari Siegel, Jean E. Kalicki, Cleary, Gottlieb, Steen & Hamilton, New York, New York, of counsel), *for Debtors in Possession-Appellants.*

MARVIN E. JACOB, New York, New York (Bruce R. Zirinsky, Bruce N. Shortt, Stephanie R. Schwartz, Gordon W. Johnson, Steve Levitan, Kurt Bjorklund, Weil, Gotshal & Manges, New York, New York, Jon Yard Arnason, John J. Reilly, Alan Heblack, Andrea Fischer, Haight, Gardner, Poor & Havens, New York, New York, James W. Giddens, David LeMay, Hughes, Hubbard & Reed, New York, New York, John I. Karesh, Jill Levi, Feltman, Karesh, Major & Farbman, New York, New York, of counsel), *for Appellees General Electric Capital Corporation, Wilmington Trust Company, Owner Trustee, Evergreen International Airlines, Inc., Cobblestone Corporation, U.S. Concord, Inc., IBJ Schroder Leasing Corporation, Greyhound Financial Corporation De Nationale Investeringsbank N.V., Credit Lyonnais/PK AIRFINANCE and Aeron Aviation, Inc.*

MIKE O. SIGAL, JR., New York, New York (Brian Trust, Daniel J. Sullivan, Simpson, Thatcher & Bartlett, New York, New York, Stephen H. Gross, Alan Kanzer, Walter

Conston Alexander & Green, New York, New York, Kathrine A. McLendon, King & Spaulding, Atlanta, Georgia, Michael Havers, Perkins Coie, Seattle, Washington, Eloise L. Morgan, Robert Gray, Winthrop, Stimson, Putnam & Roberts, New York, New York, Steven J. Howell, Honigman Miller, Schwartz & Cohn, Detroit, Michigan, of counsel), *for Appellees C.I.T. Leasing Corporation, The CIT Group/ Equipment Financing, Inc., PS Group, Inc., Grand Central Partners Nos. 1-3, United States Airlease, Inc., Airlease Ltd., CL Aircraft VII, Inc., British Aerospace, Inc., Jet Acceptance Corporation, Pacific Harbour Capital, Inc., Four-Seven A, Inc., Aeronautics I, Inc., The Bank of New York, as Trustee.*

WILLIAM C. CLARKE, New York, New York (William R. Brennan, Lord Day & Lord, New York, New York, of counsel), *for Amici Curiae America West Airlines, Inc., American Airlines, Inc., Northwest Airlines, Inc., USAir, Inc.*

WILLAIM J. ROCHELLE III, New York, New York (Courtney Katzenstein, Fulbright & Jaworski, New York, New York, Zack A. Clement, Hugh E. Tanner, Joseph G. Epstein, Lucas T. Elliot, Fulbright & Jaworski, Houston, Texas, James L. Patton, Jr., William D. Johnston, Laura D. Jones, Young, Conaway, Stargatt & Taylor, Wilmington, Delaware, Paul P. Welsh, Karen A. Jacobs, Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, of counsel) *for Amici Curiae Continental Airlines, Inc.*

BENNETT BOSKEY, Washington, D.C. (Ellis Lyons, Edward A. Groobert, Morris Klein, Volpe, Boskey and Lyons, Washington, D.C., of counsel), *for Amicus Curiae American Association of Equipment Lessors.*

PER CURIAM:

Debtors in possession Pan Am Corporation, *et al.*, appeal from an order affirming the bankruptcy court's ruling that lessors' actions to recover airplanes and equipment leased to Pan Am in certain sale-leaseback transactions may be exempted from the automatic stay by operation of Section 1110 of the Bankruptcy Code. *See* 11 U.S.C. § 1110 (1988). We now affirm the district court's order for substantially the reasons stated by Judge Mukasey. *See In re Pan Am Corporation*, ____ B.R. ____, 1991 WL 38056 (S.D.N.Y. Mar. 18, 1991).

The stay pending appeal will be extended until noon, April 5, 1991, in order to allow appellants to seek temporary relief from the Supreme Court. It shall thereafter expire.

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Docket No. 91-5023

Filed: April 3, 1991

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the 3rd day of April one thousand nine hundred and ninety-one.

IN RE: PAN AMERICAN CORPORATION; PAN AMERICAN WORLD AIRWAYS, INC.; PAN AMERICAN SHUTTLE, INCORPORATED; PAN AM EXPRESS; PAA CORPORATION; ALLMAT INTERNATIONAL, INCORPORATED; ALERT MANAGEMENT SYSTEMS, INCORPORATED; PAN AMERICAN COMMERCIAL SERVICES, INCORPORATED,

Debtor,

SECTION 1110 PARTIES; OMNIBUS SECTION 1110 PARTIES; PS GROUP, INC.; GRAND CENTRAL PARTNERS NO. 1; GRAND CENTRAL PARTNERS NO. 2; GRAND CENTRAL PARTNERS NO. 3; UNITED STATES AIRLEASE, INC.; CL AIRCRAFT VII, INC; C.I.T. LEASING CORPORATION; THE CIT GROUP/EQUIPMENT FINANCING, INC.; UNITED STATES TRUST COMPANY OF NEW YORK, as indenture trustee; NMB LEASE NV; ORIX CORPORATION; NISSHO IWAI CORPORATION; C. ITOH 7 CO., LTD; CITIBANK, N.A.; CITICORP NORTH AMERICA, INC., formerly doing business as Citicorp Industrial Credit, Inc.; DE NATIONALE INVESTERINGSBANK N.V.; GREYHOUND FINANCIAL CORPORATION; PK FINANS INTERNATIONAL CORPORATION; WESTINGHOUSE CREDIT CORPORATION; AERON AVIATION CORPORATION; IBJ SCHROEDER

LEASING CORPORATION; U.S. CONCORD, INC.; LDI FINANCIAL SERVICERS CORPORATION; PLC LEASING CORPORATION; PROGRESS LEASING CORPORATION; BRITISH AEROSPACE, INC.; JET ACCEPTANCE CORPORATION; ROLLS ROYCE CREDIT CORPORATION; ROLLS ROYCE HOLDINGS, INC.; AVIONS DE TRANSPORT REGIONAL G.I.E., on behalf of itself and Wilmington Trust Company; NEW ENGLAND MERCHANT LEASING CORPORATION; MANHATTAN BAIL, G.I.E.; THE CONNECTICUT NATIONAL BANK; WESTINGHOUSE CREDIT CORPORATION; MANHATTAN LEASE, G.I.E.; CHRYSLER CAPITAL CORPORATION; BARCLAYS BANK; THE CONNECTICUT NATIONAL BANK AND TRUST COMPANY, N.A.; PACIFIC HARBOR CAPITAL INC.; G.M. AVIATION SERVICES S.A.; UNIBANK A/S, NEW YORK BRANCH; INTEGRATED AIRCRAFT CORPORATION; NATIONAL WESTMINSTER BANK; INTEGRATED AIRCRAFT CORPORATION; AERONAUTICS FOUR-SEVEN A, INC.; AERONAUTICS I, INC.; THE BANK OF NEW YORK, as Trustee; EVERGREEN INTERNATIONAL AIRLINES, INC.; EVERGREEN VENTURE, INC.; COBBLESTONE CORPORATION; WILMINGTON TRUST COMPANY; GENERAL ELECTRIC CAPITAL CORPORATION; OFFICIAL UNSECURED CREDITORS COMMITTEE; UNITED AVIATION SERVICES; WELLS FARGO BANK NATIONAL ASSOCIATION,

Respondents-Appellees,

—v.—

PAN AMERICAN CORPORATION,

Debtor-Appellant.

It is now hereby ORDERED that the mandate in this case will issue at noon on Friday, April 5, 1991.

/s/ J. EDWARD LUMBARD
HON. J. EDWARD LUMBARD, U.S.C.J.
per RKW

/s/ RALPH K. WINTER
HON. RALPH K. WINTER, U.S.C.J.

/s/ JOHN M. WALKER, JR.
HON. JOHN M. WALKER, JR., U.S.C.J.
per RKW

APPENDIX B

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

91 Civ. 1659 (MBM)

In Re

PAN AM CORPORATION, *et al.*,

Debtors.

OPINION AND ORDER

APPEARANCES:

THOMAS J. MOLONEY, ESQ.
JEROME E. HYMAN, ESQ.
ROBERT P. DAVIS, ESQ.
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MICHAEL B. MUKASEY, U.S.D.J.

Pan Am Corporation, *et al.*, debtors and debtors in possession (collectively "Pan Am") filed a petition for reorganization under Chapter 11 of the Bankruptcy Code (the "Code") on January 8, 1991. On February 22, 1991, Pan Am moved in the Bankruptcy Court for the Southern District of New York, by order to show cause, for an order authorizing it to cure defaults in certain transactions pursuant to § 1110 of the Code and declaring that certain other transactions are not covered by § 1110. After notice, and a hearing on March 7, 1991, the Bankruptcy Court, Hon. Cornelius Blackshear, Bankruptcy Judge, issued an opinion from the bench and entered a written order dated March 8, 1991, granting in part and denying in part Pan Am's motion, and reserving decision on unresolved issues—in particular whether certain leases were actually loan transactions rather than true leases. Pan Am has informed this court, by letter dated March 11, 1991,

that it is appealing the following dispositions contained in Judge Blackshear's March 8 order:

Order ¶ 5: "Transactions designated by Debtors as 'nonacquisition sale/leaseback transactions' are not disqualified from the protection of Section 1110 solely because they are 'nonacquisition sale/leaseback transactions.' "

Order ¶ 8: "The liens in favor of General Electric Capital Corporation ("GECC") securing the Debtors' obligations arising under the 1985 loans described in paragraphs 18-25 of the Declaration [of Joan Fabio, Assistant Treasurer of Pan American World Airways, Inc.] are purchase money security interests entitled to the protection of Section 1110 of the Code to the extent of the outstanding balance of the 1985 loans, to the extent GECC can identify the amount of the debt and the Aircraft and/or Equipment to which it relates."

At a hearing on March 8, 1991, this court denied Pan Am's request for a stay pending appeal of Judge Blackshear's order, but agreed to decide on an expedited basis the appeal of the sale-leaseback issue arising from paragraph 5 of the Bankruptcy Court's order.[1] This opinion relates only to that issue. A later decision will resolve the GECC purchase-money equipment security issue arising from paragraph 8 of the Bankruptcy Court's order. For the reasons set forth below, paragraph 5 of the order, determining that sale-leaseback transactions are within § 1110, is affirmed.

I.

Section 1110 of the Bankruptcy Code provides in relevant part:

> (a) The right of a secured party with a purchase-money equipment security interest in, or a lessor or conditional

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1 Subsequently, Pan Am appealed this court's denial of a stay to the Court of Appeals for the Second Circuit. By order dated March 12, 1991, the Hon. Jon O. Newman, Circuit Judge, granted Pan Am's request for a stay, pending hearing and disposition of the stay motion before a full panel on March 19,1991.

seller of, whether as trustee or otherwise, aircraft, aircraft engines, propellers, appliances, or spare parts, as defined in section 101 of the Federal Aviation Act of 1958, . . . that are subject to a purchase money equipment security interest granted by, leased to, or conditionally sold to, a debtor that is an air carrier operating under a certificate of convenience and necessity issued by the Civil Aeronautics Board . . . to take possession of such equipment in compliance with the provisions of a purchase money equipment security agreement, lease, or conditional sale contract, . . . is not affected by section 362 or 363 of this title or by any power of the court to enjoin such taking of possession, unless—

(1) before 60 days after the date of the order for relief under this chapter, the trustee, subject to the court's approval, agrees to perform all obligations of the debtor that become due on or after such date under such security agreement, lease, or conditional sale contract, as the case may be; and

(2) any default, other than a default of a kind specified in section 365(b)(2) of this title, under such security agreement, lease, or conditional sale contract, as the case may be—

(A) that occurred before such date is cured before the expiration of such 60-day period; and

(B) that occurs after such date is cured before the latter of—(i) 30 days after the date of such default; and (ii) the expiration of such 60-day period.

. . . .

11 U.S.C. § 1110 (1991).

As mentioned, the only issue on this expedited appeal is whether the term "lessor" includes those lessors that acquired such status in "non-acquisition sale/leaseback transactions." Pan Am argues that Congress intended the statute to apply only in circumstances where a lessor leases aircraft and related equipment which are new to the airline. Therefore, Pan-Am contends that "lessor" as used in § 1110 actually means "lessor of newly acquired equipment." The

challenged sale-leaseback transactions are described in Exhibit A of the February 22, 1991 "Declaration of Joan Fabio in Support of Debtors' Motion . . ." ("Fabio Decl."). The challenged leases and subleases involve approximately 29 assorted aircraft, including commuter planes operated by Pan Am Express, Inc., and one lease involving two Pratt & Whitney aircraft engines leased by Pan Am Express. If these lease transactions are outside the reach of § 1110, Pan Am will avoid the burden of curing approximately $33 million in pre- and post-petition defaults now existing with respect to those transactions. Fabio Decl., ¶ 2(b). Pan Am concedes for present purposes that § 1110 covers acquisition of any equipment new to the airline, even used equipment. Debtors' Memorandum of Law at 13, n.2.

The lessors involved in the challenged sale-leaseback transactions contend that "lessor," as used in § 1110, unambiguously applies to any true lessor, and that the legislative history does not indicate that the leased equipment must be new to the airline—at least with the clarity required to edit a statute. This dispute presents a straightforward problem of statutory interpretation.

II.

That straightforward problem is itself to be resolved by applying equally straightforward principles of statutory interpretation:

> "The plain meaning of legislation should be conclusive, except in the 'rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intention of its drafters.' "

United States v. *Ron Pair Enterprises. Inc.*, 109 S.Ct. 1026, 1031 (1989) (quoting *Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 571 (1982)) (brackets in original). *See also Demarest* v. *Manspeaker*, 111 S.Ct. 599, 604 (1991); *In re Chateaugay Corp.*, 920 F.2d 183, 184 (2d Cir. 1990).

This basic rule of statutory construction has been applied to interpret the very statute at issue here, § 1110. *In re Air Vermont*, 761 F.2d 130, 134 (2d Cir. 1985) ("[where] the statute is unambiguous on its face . . . the statute's literal meaning must be applied" unless "there is something to make plain the intent of Congress that the letter of the statute is not to prevail"). *In Air Vermont*, the Second Circuit, noting that "the statute's literal meaning must be applied," reversed an order of the bankruptcy court which read into § 1110 an additional, unstated statutory requirement that a conditional seller perfect its security interest by filing its contract with the Federal Aviation Administration. *Id.* at 134.

These principles of statutory construction do not call simply for a mechanical application of what some call "the plain meaning rule." Rather, courts may and should examine legislative history to determine a statute's purpose and then apply that purpose, if the plain meaning produces an "unreasonable" result "*plainly* at variance with the policy of the legislation as a whole . . . ." *United States v. American Trucking Ass'n*, 310 U.S. 534, 543-44 (1940) (emphasis added). *See also Korea Shipping Association v. New York Shipping Ass'n*, 880 F.2d 1531, 1537 (2d Cir. 1990) (declining to adopt dictionary meaning of "employer" under 29 U.S.C § 1381(a) (ERISA) where that result would make multi-employer pension plans "victims of the *precise* threat Congress aimed to shield them from") (emphasis added). However, a court may not use its review of the legislative history to rewrite a statute merely because the court disagrees with the manner Congress chose to further its policy. *Louisiana Pub. Serv. Comm'n v. F.C.C.*, 476 U.S. 355, 376 (1986).

On its face, the statute is unambiguous. To the extent a party is a true lessor and otherwise qualifies under the statute, it is entitled to the "extraordinary protection" of § 1110. *Vermont*, 761 F.2d at 132. The terms "lessor," "leased" and "lease" are not modified in any way which suggests that the statute was not meant to apply to lessors in a sale-leaseback transaction. The one phrase of § 1110 which does modify the term "lessor"—"whether as trustee or otherwise"—is expansive, rather than restrictive. Therefore, by its terms, the stat-

ute protects all "lessors," and courts should not impose the additional requirement that the lease also involve equipment new to the airline, unless the literal result would be "demonstrably at odds with the intention" of Congress. *Ron Pair Enterprises*, 109 S.Ct. at 1031.

As thoroughly discussed in *In re Braniff, Inc.*, 110 B.R. 980, 983 (Bankr. M.D. Fla. 1990), the legislative history fails to demonstrate that Congress intended § 1110 to apply only to lessors of newly acquired equipment—at least with the level of clarity required for a court to edit a statute. Although the holding in that case may be somewhat limited by the court's reference to the debtor's status as a newly formed airline, an independent reading of the legislative history demonstrates that Congress did not "make plain [an] intent" to impose an acquisition element to lease transactions covered by § 1110, contrary to the "letter of the statute," which has no such element. *Vermont*, 761 F.2d at 134.

The immediate predecessor statute of § 1110 was § 116(5) of the Bankruptcy Act.[2] That statute, which was enacted in 1957, exempted "any owner" and "any other lessor" of equipment "leased, subleased or conditionally sold" to an airline from the provisions of chapter X of the Act. Section 116(5) of the Act in turn was based on an amendment to § 77(j), enacted in 1935, which earlier had given similar protection to "any owner, whether as trustee or otherwise, [of]

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2 Section 116(5) of the Act provided:

> Notwithstanding any other provision of chapter X, the title of any owner, whether as trustee or otherwise, to aircraft, aircraft engines, propellers, appliances, and spare parts (as any of such are defined in the Civil Aeronautics Act of 1938, as now in effect or hereafter amended) leased, sub-leased, or conditionally sold to any air carrier which is operating pursuant to a certificate of convenience and necessity issued by the Civil Aeronautics Board and any right of such owner or of any other lessor to such air carrier to take possession of such property in compliance with the provisions of any such lease or conditional sale contract shall not be affected by the provisions of chapter X if the terms of such lease or conditional sale so provide.

Pub. L. No. 85-295, 71 Stat. 617, *reprinted in* 1957 U.S. Code Cong. & Admin. News 681.

rolling-stock equipment leased or conditionally sold to the debtor . . . ." *See* Act of August 27, 1935, pub. L. No. 74-381, ch. 774, 49 Stat. 922. That provision had been enacted "[i]n view of the necessity of readily financing purchases of new equipment at a time when the development of the transportation art is providing new forms of equipment . . . ." H.R. Rep. No. 1283, 74th Cong., 1st Sess. 4 (1935).

By its terms, § 116(5) gave protection to any party with title to leased equipment, and did not distinguish between lessors of equipment new to the airline and other lessors. Although the legislative history of that statute shows a Congressional concern with the need of airlines to "replace obsolete equipment with modern aircraft," the House Report reflects Congressional awareness that a major impediment to this goal was the inability of airlines to attract necessary capital. *See* H.R. Rep. No. 944, 85th Cong., 1st Sess., *reprinted in* 1957 U.S. Code Cong. & Admin. News 1926. The then-proposed amendment to the Act would "result in an increased availability of capital at a lower interest rate than would be demanded under present conditions." *Id.* Therefore, although Congress may have had the ultimate end in 1957 of encouraging airlines to acquire new equipment, one means to that end incorporated in the statute was to increase the availability and decrease the cost to an airline of capital. Thus, the encouragement of new equipment acquisition can in no way be considered directly contrary to the broad language which Congress chose to use. *See also In re Airlift Intern, Inc.*, 761 F.2d 1503, 1507 (11th Cir. 1985) (the purpose of § 116(5) was "to enhance the borrowing ability of airlines"); 5 *Collier On Bankruptcy*, ¶ 1110.01, at 1110-3 (L. King 15th ed. 1990) (the predecessor provisions of § 1110 "were designed to afford equipment financers greater certainty than existed under the other provisions of the Bankruptcy Act concerning such financers").

When the current Bankruptcy Code was adopted in 1978, the category of protected creditors was expanded to include secured parties with a "purchase-money equipment security interest." To the extent the legislative history of § 1110 discusses prior law, it shows that Congress continued to be con-

cerned with the need to encourage low cost financing of the airline industry. There is no clearly expressed intention for the new statute to restrict the types of lessors seemingly protected by the broad references in prior law to "any owner" or "any other lessor." In the House Report accompanying § 1110, Congress noted that the protection in the Bankruptcy Act had been "added as a means of encouraging new financing" in the airline industry. H.R. Rep. 595, 95th Cong., 1st Sess. 240, *reprinted in* 1978 U.S.Code Cong. & Ad. News 6199. The House Report further noted that "[w]hether or not there was an initial need for these provisions, their existence has become largely addicting to the financing industry, and now the industry claims it would simply cease financing of the relevant equipment if the protections were removed." *Id.*

Later on, discussing intended "changes" from the provisions of the prior Bankruptcy Act, the House Report first noted an intent "to preserve the limitations on the right of the financer contained in current law." *Id.* at 240. The Report then stated that in the new Bankruptcy Code, the list of protected transactions would be expanded to include "equipment security interests," with the limitation that "[t]he term includes only security interests that were granted to finance the acquisition of the covered equipment," while "[a] general mortgage is excluded." *Id.* Elsewhere, the report stated that "this section, to a large degree, preserves the protection given lessors" under prior law. *Id.* at 405.

The House Report explained the law's expansion to include certain secured lenders, and stated that the Bankruptcy Act had applied only to leases and conditional sales under the theory that in those transactions title to equipment remained with the "financer" and did not pass to the airline. *Id.* However, noting the changes in financing practices brought about by the adoption of Article 9 of the Uniform Commercial Code, in which a seller receiving a security interest did not retain title, the House Report then stated that "protection of security interests was added to make financing forms more flexible and more consonant with modern law." *Id.*

Pan Am cites these passages to argue that Congress intended the acquisition of newly acquired equipment to be a

necessary element for *all* § 1110 transactions, including leases. However, that history demonstrates with precision only that Congress refused to include Article 9 transactions within § 1110 unless they included an acquisition element; it fails to show with any clarity that Congress also intended to add an acquisition element to lease transactions. Of course, with respect to Article 9 transactions, Congress also demonstrated its intention in the clearest way it could, through the words it used, by limiting the statutory protection to a "secured party with a *purchase-money* equipment security interest." 11 U.S.C. § 1110(a) (emphasis added). There is no such statutory restriction on lease transactions within § 1110.

Pan Am also cites the following passage from the Congressional record: "This section protects a limited class of financers of aircraft and vessels and is intended to be narrowly construed to prevent secured parties or lessors from gaining the protection of the section unless the interest of such lessor or secured party is explicitly enumerated therein." 124 Cong. Rec. S17,419 (daily ed. Oct. 6, 1978). That statement does not prove Pan Am's case because "the interest of such lessor . . . [as] explicitly enumerated" in the statute is simply that of a "lessor" of qualified equipment to a qualified carrier. Moreover, the value of statements in the Congressional Record as barometers of legislative intent is minimal at best. *Begier v. I.R.S.*, 110 S.Ct. 2258, 2268 (1990) ("Congress conveys its directions in the Statutes at Large, not in excerpts from the Congressional Record") (Scalia, J., concurring).

If anything, the legislative history of § 1110 suggests that the Congressional omission of an acquisition element in lease transactions under § 1110 was intentional. In particular, the House Report noted that the protection provided by § 1110 to lessors of aircraft equipment was similar to the protection provided to other types of lessors elsewhere in the Code, except that with respect to § 1110, debtors were forced to make a decision on whether to assume or reject a lease within 60 days. H.R. Rep. 595, 95th Cong., 1st Sess. 240. Section 365 is the general Code provision defining a debtor's rights and obligations with respect to unexpired leases. Unlike § 1110, § 365(d)(2) generally allows a debtor to assume or

reject an unexpired lease of residential real property or of personal property "at any time before confirmation of a plan" unless a court orders otherwise, while § 365(b)(1) gives a debtor who chooses to assume an unexpired lease the option of either curing past defaults or "provid[ing] adequate assurance" of prompt cure. Significantly, § 365, like § 1110, also makes no distinction between leases of newly acquired equipment and leases that are part of a sale-leaseback transaction. Moreover, the text of § 365 demonstrates that when Congress wrote the Code, including § 1110, it knew how to distinguish among categories of lessors when it so desired. *See, e.g.*, § 365(h) (consequences to lessee of rejection by trustee of "an unexpired *lease of real property* of the debtor under which the debtor is the lessor") (emphasis added). Of course, § 1110 also distinguishes different types of lessors: it protects only lessors that lease qualified equipment to qualified airlines. However, Congress did not include the additional requirement that the qualified equipment be new to the qualified airline.

Pan Am argues also that because § 1110 *explicitly* limits protected security interests to those arising from acquisitions, it also *implicitly* limits leases in the same way. Yet by its terms, the statute protects "[t]he right of a secured party with a purchase-money equipment security interest in, *or* of a lessor *or* conditional vendor of, . . . [qualified aircraft equipment]." 11 U.S.C. § 1110(a) (emphasis added). Pan-Am's argument here contradicts both logic and rules of statutory construction. Congress placed explicit limitations on one group, by defining a protected secured party as "a secured party with a purchase money equipment security interest," without similarly limiting another in the same statute: a "lessor" is not limited to a lessor of newly acquired equipment. That difference suggests the logical conclusion that Congress actually did *not* intend so to restrict the class of protected lessors. Although acquisition inheres in the conduct of the third group of protected parties, "conditional vendor[s]," because

of the very nature of conditional sale transactions,[3] there is no such inherent acquisition element with respect to "lessor[s]." Leases arising out of sale-leaseback transactions are analyzed the same as ordinary leases. *See Frank Lyon* v. *United States*, 435 U.S. 561, 581 (1978) (lessor in sale-leaseback entitled to depreciation deductions). Finally, when Congress separates words or phrases in a statute with the conjunction "or," the Supreme Court has directed courts to give each term its "ordinary, separate meaning." *Garcia* v. *United States*, 469 U.S. 70, 73-75 (1984). Thus, the acquisition element explicitly imposed on secured parties, and the acquisition element inherent in the status of conditional vendors, implies no such acquisition element with respect to lessors—a separate class of parties protected by the statute.

The distinction Pan Am would draw, based on legislative history, between sale-leasebacks and conventional leases would generate numerous additional issues that could not be resolved by that legislative history. In the future, there would likely be litigation on whether the words Pan Am hopes to read into the statute through references to selected legislative history limit the protection of § 1110 to lessors of brand new equipment, lessors of equipment new to the debtor airline, lessors of equipment new to the debtor airline and also new to any predecessor of the debtor airline, *see Braniff*, 110 B.R. at 985, or some other category.[4] In addition, it would be unclear whether the statute applies to lease renewals if the equipment was new to the airline at the beginning of the ini-

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3 *See* Gerstell & Hoff-Patrinos, *Aviation Financing Problems Under Section 1110 of the Bankruptcy Code*, Am. Bankr. L.J. 1, 24-25 (1987) (noting that at the time of the enactment of § 1110's predecessors, "there already was a well developed body of law limiting the conditional sales priority to true purchase-money financing").

4 *See* Goldman, Album & Ward, *Repossessing the Spirit of St. Louis: Expanding the Protection of Sections 1110 and 1168 of the Bankruptcy Code*, 41 Bus. Law. 29, 53-54 (1985) (suggesting that post-acquisition sale-leaseback transactions generally should not qualify for § 1110 protection, but that the section should apply if the aircraft was owned by the airline only during the 90-day period in which the tax laws permit a lessee to transfer the benefits of an investment tax credit).

tial lease term.[5] As mentioned, Pan-Am concedes for purposes of this motion that § 1110 applies to leases of used equipment so long as that equipment is new to the airline. Yet this concession itself does not seem to arise from anything in the legislative history. In fact, although the issue was not treated by the Second Circuit, it appears that the transaction analyzed by the Court in *Air Vermont*, and found to be within the scope of § 1110, involved a used aircraft. *Air Vermont*, 761 F.2d at 130 (conditional sale contract dated April 27, 1982 for 1977 Piper Navajo aircraft). However, if, for example, an airline desires to continue operating Boeing 727's while awaiting delivery of new replacement aircraft that comply with new noise regulations, *see* The Airport Noise and Capacity Act of 1990, Pub. L. No. 101-508, §§ 9301-09 (Nov. 5, 1990) (requiring Secretary of Transportation to implement new regulations "including the phaseout and non addition of Stage 2 aircraft"), and would like to finance the newer aircraft in part through a sale-leaseback of the older planes, there is no principled distinction between a lease that involves the used aircraft previously owned by the airline, and a transaction in which the airline simply adds the step of trading its planes for identical used equipment, or similar used equipment such as DC-9's, controlled by an airline broker or owned by another airline interested in doing the same type of transaction. In cases such as this where the legislative history appears to reflect many seemingly different but consistent goals, courts should be reluctant to rewrite the words of a statute unless the plain meaning of those words leads to a result clearly contrary to Congress' expressed intention. Otherwise, the benefit sought to be achieved by a statute like § 1110—the prospect of a quick and predictable remedy that encourages potential financers to be forthcoming—will be lost in a miasma of potential litigation. Here, the best rule of law may be a rule of thumb, with protection for all transac-

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5 *See* Giddens & Schick, *Section 1110 of the Bankruptcy Code: Time for Refueling?*, Am. Bankr. L.J. 109, 123, 128 n. 56 (1990) (suggesting that "if lease renewals are contemplated at the commencement of a lease of equipment that the airline did not previously possess, then the renewals should be afforded the protection of § 1110").

tions that meet the statutory requirements Congress itself imposed. "[T]his is a case for applying the canon of construction of the wag who said, when the legislative history is doubtful, go to the statute." *Greenwood* v. *United States*, 350 U.S. 366, 374 (1956) (Frankfurter, J.).

Including all lessors within the scope of § 1110 would certainly not create an absurd or even unreasonable result. In fact, it is directly consistent with Congress' stated policy of increasing capital availability at the lowest possible cost. *See Seidle* v. *GATX Leasing Corp.*, 778 F.2d 659, 663 (11th Cir. 1985) ("Congress intended that section 1110 encourage *new financing* of . . . airplanes.") (emphasis added). That stated legislative purpose is consistent with Congress' ultimate goal of fleet modernization. *See In re Air Vermont*, 761 F.2d at 132 ("Congress did intend to extend extraordinary protection *to financiers of aircraft* in order to encourage investment in new equipment for air carriers.") (emphasis added). Although a "lessor" that leased new equipment to an airline in reliance on the statute would directly further Congress' goal, a lessor who purchased and then leased an airline's existing equipment also would further that goal, albeit indirectly, by freeing up the equity in the airline's primary existing asset, its equipment fleet. A sale-leaseback benefits the lessor by allowing it to take advantage of tax deductions that may be unavailable to the airline. The lessor also can anticipate some future return from the aircraft's residual value after expiration of the lease. *See generally* Kruft, *Leveraged Aircraft Leases: The Lender's Perspective*, 44 Bus. Law. 737, 738 (1989). Because of these benefits, a lessor in a sale-leaseback transaction is often an airline's cheapest source of low cost financing for fleet modernization. Moreover, besides using what is likely to be an airline's least expensive source of capital—its own—a sale-leaseback enables the airline to retain use of existing equipment and therefore continue operations during the time lag between order and delivery of new equipment.

Sale-leaseback transactions of the type and complexity in which Pan Am engaged may not have been directly contemplated at the time of the statute's enactment, nor explicitly

mentioned in the legislative history,[6] and may or may not have been a relatively innovative technique in 1957 and 1977, when the statutes were enacted. *Contrast In re PCH Assocs*, 804 F.2d 193, 200 (2d Cir. 1986) (describing sale-leasebacks as a " 'relatively modern, and clever, structure of financing.' ") (citation omitted) *with Sun Oil Co.* v. *C.I.R.*, 562 F.2d 258, 268-69 (3d Cir. 1977) ("we recognize that sale-leaseback arrangements play a useful and accepted role in our economy"); *see also Yorkshire Ry. Wagon Co.* v. *Maclure*, 21 Ch.D. 309, 319 (1882) (treating sale-leaseback of "locomotives and wagons" as bona-fide transaction). However, because Congress's broad purpose in enacting both § 157(6) of the Act and § 1110 of the Code was to increase the availability of low cost capital in order to facilitate fleet modernization, there is no clear evidence that Congress intended to limit the benefits of that section to lessors of newly acquired equipment. Congress could have accomplished its goals in many ways, for example by providing protection to any creditor of an airline, or by limiting the protection to lessors of newly acquired equipment; it could also have helped the aircraft manufacturing industry by providing protection only to lessors of new equipment manufactured in the United States. For reasons it deemed sufficient, Congress chose simply to provide protection to a "lessor" without restriction and "whether as trustee or otherwise," so long as the lease involved "aircraft, aircraft engines, propellers, appliances, or spare parts, as defined in section 101 of the Federal Aviation Act of 1958," and so long as the equipment was leased to an "air carrier operating under a certificate of convenience and necessity issued by the Civil Aeronautics Board." 11 U.S.C. § 1110(a).

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6 Congress was certainly familiar with sophisticated leveraged lease transactions. *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 405, *reprinted in* 1978 U.S. Code Cong. & Admin. News 5963, 6361 (stating that § 1110 applies with equal force whether "the debtor has granted the security interest to the financer or if the debtor is leasing equipment from a financer that has leveraged the lease and leased the equipment subject to a security interest of a third party").

Pan Am argues that this interpretation of § 1110 would allow parties that are in substance non-purchase money secured lenders to receive the protection of § 1110 by doing little more than using the word "lease" in their transactional documents. Yet a court that applies the provisions of the Code to a set of facts must always looks beyond the form of a transaction to its substance, *Pepper* v. *Litton*, 308 U.S. 295, 305 (1939), a feat that can be accomplished with minimum time and effort here. As one pair of commentators have noted:

> "The factor of economic ownership reveals the superficiality of any resemblance between the sale-leaseback transaction and a secured loan. Where the resulting lease is a true lease, a genuine change in ownership, evidenced by a transfer of residual risk, has taken place."

Gerstell & Hoff-Patrinos, *Aviation Financing Problems Under Section 1110 of the Bankruptcy Code*, Am. Bankr. L.J. 1, 25 (1987). In drafting § 1110, Congress was keenly aware of the Uniform Commercial Code's distinction, *see* § 1-201(37) (McKinney's 1991), between true leases and "leases that are merely disguised security agreements," H.R. Rep. 595, 95th Cong., 1st Sess. at 240, and a court can certainly conduct such an analysis in any proceeding to determine whether a "lease" claiming § 1110 protection is in fact a loan. *See In re PCH Associates*, 804 F.2d at 199-200 (ground lease with initial term of 33 years, renewable for an additional 165 years, was in substance a loan transaction rather than bona fide lease within the meaning of § 365); *In re Chateaugay Corp.*, 102 B.R. 335, 343 (Bankr. S.D.N.Y. 1989) (status of sale-leaseback under Code depends on "whether the leaseback actually transfers the normal risks and responsibilities of lessor status"). Because Judge Blackshear reserved decision on whether certain leases between Pan Am and others were in fact true leases, *see* Order ¶ 10, that issue is not presented here.

Neither the words and structure of the statute, nor the legislative history of either § 1110 or that section's Bankruptcy Act predecessor, indicate that including all lessors within the

protection of § 1110 would produce a result "demonstrably at odds with the intention of its drafters." *Ron Pair Enterprises*, 109 S.Ct. at 1031. If the lease is a true lease, rather than a disguised loan, and meets all other elements of the statute—*e.g.* qualified equipment, qualified air carrier, repossession clause in lease—the lessor is protected by § 1110. To the extent this decision conflicts with the recent bench decision of Judge Balick of the Bankruptcy Court for the District of Delaware, I respectfully disagree with the analysis and application of the legislative history in that case. *See* Transcript, *In re Continental Airlines, Inc.*, Nos. 90-932 through 90-980 (Bankr. D. Del. January 30, 1991), *appeal pending, In re Continental Airlines, Inc.*, No. 91-58 (RSG) (D. Del.).

Paragraph 5 of the Bankruptcy Court's order is affirmed.

SO ORDERED:

/s/ MICHAEL B. MUKASEY
Michael B. Mukasey,
U.S. District Judge

Dated: New York, New York
March 18, 1991

APPENDIX C

UNITED STATES BANKRUPTCY COURT

SOUTHERN DISTRICT OF NEW YORK

Chapter 11
Case No. 91 B 10080
through 91 B 10087 (CB)

Docketed March 15, 1991

In re

PAN AM CORPORATION, *et al.*,

Debtors.

DECISION ON DEBTORS' MOTION PERTAINING TO SECTION 1110 OF THE BANKRUPTCY CODE

Before:

HON. CORNELIUS BLACKSHEAR,
Bankruptcy Judge.

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THE MOTION

Pan Am Corporation *et al.* (the "Debtors") have filed a motion seeking a determination as to the reach of section 1110 of the Bankruptcy Code (the "Code"). Specifically, they seek a Court Order:

(a) declaring that the Debtors' non-acquisition sale lease-back transactions (the "Sale-Leasebacks") are not covered by Section 1110;

(b) declaring that certain of the Debtors' leases are not covered by section 1110 because they did not enable the Debtors to newly-acquire aircraft but rather were subsequently negotiated renewals or extensions of existing leases;

(c) declaring that certain aircraft are not covered by section 1110 because they were not acquired by an air-carrier that had the necessary certificate of convenience and necessity required for coverage under section 1110;

(d) declaring that section 1110 does not apply to certain transactions with General Electric Capital Corporation ("GECC") in which GECC does not have a purchase money equipment security interest ("PMESI") in certain aircraft and equipment owned by the Debtors;

(e) declaring that certain loan transactions with United Technologies Corporation and UT Finance Corporation (collectively, "UT") are not covered by section 1110 because UT does not have a PMESI in the engines serving as collateral for these loans;

(f) authorizing the Debtors to cure defaults relating to those transaction that the Debtors have preliminary determined are covered by section 1110 (the "Section 1110 Transactions"), subject to the Debtors' express reservation of its rights;

(g) declaring that cure payments by section 1110 do not include penalties, default interest, attorneys' fees and other payments owed by Debtors according to the terms of the relevant agreements as a result of Debtors' default under those agreements and declaring that Debtors are entitled to a credit for any cash deposit;

(h) declaring that all transactions concerning the use and/or possession of aircraft and related equipment to which any Debtor is a party, other than those transactions to which the Debtors concede are 1110 transactions, and precluding any party that fails to file a timely objection to this motion from claiming that section 1110 applies to any transaction; and

(i) such other relief as the Debtors may seek by proposed order from this Court as warranted by the Debtors' financial condition at the end of the 60-day period provided in section 1110.

At a hearing, held on March 7, 1991, this Court heard oral argument from the Debtors in support of their motion, from those parties in support of the Debtors' motion and from those parties opposing the Debtors' motion. This Court issued an oral ruling as to part of the Debtors' motion and reserved the right to issue a written decision. The portion of the Debtors' motion which questioned what "cure" under section 1110 entails was left for another day. In the interim, the Debtors were directed to make timely cure payments consisting of those amounts not in dispute.[1] This Court's oral ruling addressed the applicability of section 1110 to:

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1 The issues in dispute, including the attorneys' fees, penalty default interest rate, debtor-in-possession junior liens, and reservation of rights, will be addressed in the future at which point this Court will have an opportunity to fully review the relevant evidence.

(a) sale-leaseback transactions;

(b) lease extensions and renewals;

(c) leases with non-certified Debtors;

(d) the PMESI transaction entered into with GECC;

(e) the equipment switching/pooling arrangements.

In addition this Court also discussed what is referred to as the "True Lease" issue. This decision memorializes the aforementioned oral ruling rendered on March 7, 1991.

BACKGROUND

On January 8, 1991 (the "Petition Date") the Debtors filed their respective petitions for reorganization under Chapter 11 of the Code. By an order dated January 8, 1991, this Court approved the joint administration of the Debtors chapter 11 cases for procedural purposes. The Debtors continue to manage and operate their businesses and properties pursuant to sections 1107 and 1108 of the Code.

The Debtors are part of a multinational organization that provides air transportation and transportation-related services in the United States and throughout the world. Pan Am Corporation is a holding company that directly or indirectly owns all of the issued and outstanding stock of the other Debtors, including Pan American World Airways, Inc. ("Pan Am") and Pan Am Express ("Express"). Pan Am Shuttle, Inc. ("Shuttle"), another subsidiary of Pan Am Corporation, provides hourly shuttle service between New York City and both Boston and Washington D.C..

Pan Am currently operates a fleet of 154 jet powered aircraft. Express, which serves as a feeder-carrier for the Debtors' international routes and provides service in the United States and Europe, operates 32 commuter aircraft (collectively with the Pan Am aircraft described above, the "Aircraft"). The Debtors also own or "lease" various spare engines and spare parts (together with the Aircraft, the "Aircraft and Equipment"). The Aircraft and Equipment are the

subject of leases, subleases, conditional sales agreements and security agreements (collectively the "Agreements").

Each of the Debtors presently holds one or more certificates of convenience and necessity within the meaning of section 1110 (the "Certificate"). Express did not acquire its Certificate until December 31, 1987.

I. THE SALE-LEASEBACKS

Section 1110 of the Bankruptcy Code provides as follows:

> (a) The right of a secured party with a purchase-money equipment security interest, or of a lessor or conditional vendor of, whether as trustee or otherwise, aircraft, aircraft engines, propellers, appliances, or spare parts, as defined in section 101 of the Federal Aviation Act of 1958 (49 U.S.C. 1301), or vessels of the United States, as defined in subsection B(4) of the Ship Mortgage Act, 1920 (46 U.S.C. 911(4)), that are subject to a purchase-money equipment security interest granted by, leased to, or conditionally sold to, a debtor that is an air carrier operating under a certificate of convenience and necessity issued by the Civil Aeronautics Board, or a water carrier that holds a certificate of public convenience and necessity or permit issued by the Interstate Commerce Commission, as the case may be, to take possession of such equipment in compliance with the provisions of a purchase-money equipment security agreement, lease, or conditional sale contract, as the case may be, is not affected by section 362 or 363 of this title or by any power of the court to enjoin such taking of possession, unless—
>
> > (1) before 60 days after the date of the order for relief under this chapter, the trustee, subject to the court's approval, agrees to perform all obligations of the debtor that become due on or after such date under such security agreement, lease, or conditional sale contract, as the case may be; and

(2) any default, other than a default of a kind specified in section 365(b)(2) of this title, under such security agreement, lease, or conditional sale contract, as the case may be—

(A) that occurred before such date is cured before the expiration of such 60-day period; and

(B) that occurs after such date is cured before the later of—

(i) 30 days after the date of such default; and

(ii) the expiration of such 60-day period.

(b) The Trustee and the secured party, lessor, or conditional vendor, as the case may be, whose right to take possession is protected under subsection (a) of this section may agree, subject to the court's approval, to extend the 60-day period specified in subsection (a)(1) of this section.

Section 1110 relieves certain persons from the restrictions of the automatic stay and, subject to the terms of their individual agreements with the debtor, permits them to repossess aircraft and other equipment, unless the debtor to those agreements cures pre-petition defaults relating to those agreements within sixty (60) days of filing for bankruptcy. The debtor must cure post-petition defaults within the later of thirty (30) days of default or sixty (60) days from the petition date.

The substantive relief provided for in section 1110 is not a new concept in bankruptcy law. Indeed, section 1110 can be traced back to section 77j of the Bankruptcy Act which provided that an owner of conditionally sold or leased rolling stock could repossess the equipment from a railroad despite the commencement of a railroad reorganization case, which normally would stay such a repossession action.[2] In 1957,

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2 Section 77j provided in part:

The title of any owner, whether as trustee or otherwise, to rolling-stock equipment leased or conditionally sold to the debtor, and any such

Congress enacted section 116(5), the predecessor statute to section 1110, extending the protection of section 77j to persons who lease to or conditionally sell to a debtor who is an air carrier.[3] In enacting section 1110, Congress adopted the provisions of section 116(5) and further extended its protection to PMESIs.

Section 1110 stands in stark contrast to sections 362, the automatic stay provision, and 365, the assumption or rejection of executory contracts or leases provision, of the Code. Congress obviously saw a need for this type of special legislation in order to protect certain persons who deal with air carriers. In this bankruptcy case, the Debtors seek a determination that section 1110 was extended to give this special status to only those who provide financing for the new acquisition of specified equipment. Specifically, the Debtors are of the view that the Sale-Leasebacks are not protected by section 1110.

This motion is made on the heels of the decision in the Continental Airlines, Inc. chapter 11 case wherein the bankruptcy judge squarely held that sale-leaseback transactions not involving the acquisition of new equipment did not fall within either the letter or spirit of section 1110. *In re Continental Airlines, Inc.*, Nos. 90-932 through 90-980 (Bankr.

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owner to take possession of such property in compliance with the provisions of any such lease or conditional sale contract, shall not be affected by the provisions of this section.

41 U.S. Statutes at Large, 74th Cong., 1st Sess. § 77j at 922 (1935).

3 Section 116(5) provided:

Notwithstanding any other provisions of chapter X, the title of any owner, whether as trustee or otherwise, to aircraft, aircraft engines, propellers, appliances, and spare parts (as any of such are defined in the Civil Aeronautics Act of 1938, as now in effect or hereafter amended) leased, subleased, or conditionally sold to any air carrier which is operating pursuant to a certificate of convenience and necessity issued by the Civil Aeronautics Board, and any right of such owner or of any other lessor to such air carrier to take possession of such property in compliance with the provisions of any such lease or conditional sale contract shall not be affected by the provisions of Chapter X if the terms of such lease or conditional sale so provide.

D.Del. Jan. 30, 1991). Not surprisingly, this motion has garnered a host of opposition from lessors of aircraft, air-carrier equipment and other Airlines.[4]

As of the Petition Date, the Airlines were parties to numerous Sale-Leasebacks in which the Debtors "sold" Aircraft and Equipment which had been part of their fleet for many years to financiers, who then leased that same Aircraft and Equipment back to the Debtors. The Debtors did not acquire any new Aircraft and Equipment as a result of these transactions.

In asserting their claim, the Debtors posit that section 1110 is not clear on its face and mandates a review of legislative history, which the Debtors claim unequivocally demonstrates that Congress intended for this section to apply only to transactions involving a debtor's new acquisition of equipment.

As Justice Frankfurter wrote some 44 years ago, statutory construction begins with the reading of the actual words of the statute under scrutiny. Frankfurter, *Some Reflections on the Reading of Statutes*, 47 Colum. L. Rev. 527, 535 (1947). Under well established canons of statutory construction, when a statute is clear on its face, it should be enforced in accordance with its terms. *United States v. Hopkins*, 853 F.2d 118, 119 (2d Cir. 1988); *United States v. Payden*, 759 F.2d 202, 204 (2d Cir. 1985). Courts are reluctant to sway from the clear and unambiguous provisions of a statute. The function of the courts is to interpret and enforce the law, not create it. When a court refuses to follow the clear and unambiguous terms of a statute and instead chooses to impose its own views and modifications, it is in effect legislating.

Section 1110 clearly and unambiguously applies to "a lessor of . . . aircraft." 11 U.S.C. § 1110(a). A lessor may, unless the airline cures all defaults and performs all obligations under Section 1110, "take possession of such equipment in compliance with the provisions of a . . . lease . . . ." *Id.* The terms "lease" and "lessor" are not modified or limited by the statutory language. The Debtors perceive an ambiguity

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4 American West Airlines, Inc., American Airlines, Inc., Northwest Airlines, Inc. and USAir, Inc., all represented by Lord Day & Lord, Barrett Smith, filed an amicus brief in opposition to the Debtors' motion.

in section 1110 insofar as it seems to provide for equal treatment of leases, PMESIs and conditional sales agreements. Lease transactions are entered into for a myriad of reasons; whereas for PMESIs and conditional sales the purpose is generally the same. Specifically, PMESIs and conditional sales are created for the very purpose of financing the acquisition of equipment, in this case airline equipment. On the other hand, lease transactions, which include sale-leaseback transactions, are not always a tool for financing the new acquisition of equipment. Rather, a sale-leaseback, where the air carrier sells to the lessor an aircraft that has been part of the air carrier's fleet for a substantial period of time, is a creative means of infusing working capital into the air carrier's business. Therefore, to some, there seems to exist an inconsistency in the statute since it extends equal protection to transactions which, at first blush, do not serve the same purpose. It is possible that Congress intended to extend section 1110's coverage to only those agreements relating to the new acquisition of equipment by an air carrier. But Congress did not so qualify the statute. A plain and literal reading of the statute calls for a nonrestrictive reading of the words lease and lessor.

The Second Circuit adheres to the plain meaning doctrine of statutory construction. In *California Chieftain v. Air Vermont, Inc. (In re Air Vermont, Inc.)*, 761 F.2d 130 (2d Cir. 1985), when asked to interpret section 1110, the court stated that "the statute's literal meaning must be applied, and no condition of recording may be superimposed on the requirements explicitly specified in order for § 1110 to apply." *Id.* at 134; *see also*, *First Nat'l Bank v. Shugrue (In re Ionosphere Clubs, Inc.)*, No. 90 Civ. 4323, slip. op. at 2 (S.D.N.Y. Jan. 17, 1991). In a more recent decision, *Maritime Asbestosis Legal Clinic v. LTV Steel Co. (In re Chateaugay Corp.)*, 920 F.2d 183 (2d Cir. 1990), the Second Circuit applied a literal interpretation of section 362(h) of the Code and refused to include corporations as parties with standing to request sanctions under section 362(h) of the Code since that section only refers to "individuals" as the parties who had standing to request sanctions. A plain read-

ing of section 1110 would dictate the terms lease and lessor be given its ordinary meaning and not be qualified in any fashion.

Courts must strive to listen to what Congress says, but, as Justice Frankfurter observed, sometimes "Congress cannot be heard clearly because its speech is muffled." Frankfurter, *supra* at 536. However, review of the legislative history of section 1110 does not give this Court reason to change its decision. The legislative history seems to suggest that section 1110 was intended to protect transactions involving the financing of new acquisitions of aircraft by a debtor. Congress refers to "financiers" and "equipment financing" throughout the House Report. However, as the court in *Braniff Inc. v. Toren* (*In re Braniff, Inc.*), 110 B.R. 980, 983 (Bankr. M.D. Fla. 1990) stated, Congress probably made such constant reference to the financing of equipment because it was discussing the modification of section 1110's predecessor, section 116(5) of the Bankruptcy Act, to include PMESIs which, by their very nature relate to the new acquisition of equipment. This change from the Bankruptcy Act was Congress's reaction to "changes in financing practices and in the bankruptcy laws . . . ." H.R. Rep. No. 595, 95th Cong., 1st Sess. 240 (1977), *reprinted in*, 1978 U.S. Code Cong. & Admin. News 6200. Therefore, section 1110's legislative history does not indicate that Congress intended to limit its application to acquisition type of transactions.

Congress, however, realized that this extension of coverage was limited and did not apply to interests that amount to nothing more than a secured interest in an aircraft or other equipment. The congressional record states that "[t]he term [equipment security interests] includes only security interests that were granted to finance the acquisition of the covered equipment. A general mortgage is excluded." *Id.*

The legislative history of section 1110 should not be read in a vacuum since it is the successor to section 116(5) of the Bankruptcy Act, which expressly provided protection to lessors of aircraft and other equipment to air carriers. The possessor of the title of equipment is given much consideration in section 116(5). A look at the legislative history of section

116(5) teaches that Congress used the term lease freely without seeing a need to modify it. The professed purpose of section 116(5) was to "render immune from the provisions of chapter X of the Bankruptcy Act the *title* and right to repossession of such property." H.R. Rep. No. 944, 85th Cong., 1st Sess. (1957), *reprinted in*, 1957 U.S. Code Cong. & Admin. News 1926 (emphasis added). Again, this excerpt shows that what concerned Congress was the fact that the title in leased equipment did not lie with the debtor. Indeed, the legislative history of section 1110 also reveals Congress' concern over title. In explaining the reason for the exclusion of certain secured transactions from 1110 protection, Congress stated that "[t]he theory behind the present limitation is that under leases and conditional sales, *title* of the property does not pass to the debtor, but remains in the financier. Thus, it is appropriate to exclude what is not property of the estate from the automatic stay in a reorganization case." H.R. Rep. No. 595, 95th Cong., 1st Sess., *supra*, at 240 (emphasis added).

Additionally, the legislative history of section 116(5) of the Act explains that the reason for its enactment was to increase availability of capital to air carriers at a lower interest rate. Congress observed that:

> Testimony before the Bankruptcy Subcommittee of this committee indicated that the smaller lines are presently unable to attract the capital necessary for their current re-equipment requirements. Testimony also indicated that the enactment of this bill would result in an increased availability of capital and at a lower interest rate than would be demanded under present conditions.

H.R. Rep. No. 944 85th Cong., 1st Sess., *supra* at 1926.

The Debtors claim that the lessors involved in Sale-Leasebacks not resulting in the new acquisition of equipment are getting through the back door what they could not get through the front door. But, this is not the case. Congress spoke of the increased availability of capital at lower interest rates. The Sale-Leasebacks under attack here accomplish just that. Clearly, the Debtors were in need of increased working

capital. Had the Debtors sought a traditional secured loan, undeniably that creditor would not have enjoyed the benefits of section 1110 and therefore, most likely, would have requested a high interest rate in order to compensate for the risk it was assuming. In contrast, a person buying an aircraft from the Debtor and leasing it back would enjoy benefits of section 1110 and therefore the cost of obtaining this working capital would likely be less than if the Debtor had obtained a working capital loan using an aircraft as the collateral. The lessors were not the only ones gaining from the Sale-Leasebacks, the Debtors also benefited.

The Debtors repeat throughout their papers that a determination by this Court that these Sale-Leasebacks are section 1110 leases would cost the Debtors, approximately $33 million dollars in cure liability. The Debtors, because of their financial straights, may not be able to assume such an onerous cure liability. This troubles the Court, but the financial straights of the Debtor cannot in any way change and impact on this Court's legal analysis. Justice Cardozo once said: "We do not pause to consider whether a statute differently conceived and framed would yield results more consonant with fairness and reason. We take this statute as we find it." *Anderson v. Wilson*, 289 U.S. 20, 27 (1933). Neither the statute nor its legislative history gives this Court cause to steer away from the plain meaning of the words of section 1110. Accordingly, the terms "lease" and "lessors" will not be read narrowly, rather their common meaning will be applied.

This determination falls in line with the bankruptcy court's decision in *In re Braniff, Inc.*, and is in direct contradiction with the bankruptcy court's ruling in *Matter of Continental Airlines, Inc.* (hearing on January 30, 1991). In both of those cases, the courts were faced with the same issue this Court is faced with.[5] The fact that both courts, in turning to the legislative history, reached completely opposite results magnifies the dangers of reading a congressional record in order to

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5 The court in *Braniff* was faced with the far-reaching issue as to whether section 1110 was intended to apply to only aircraft and equipment that are newly acquired by an air carrier lessee.

"glean" the intentions of Congress.[6] The statute clearly and unambiguously refers to "lease" and "lessor" without modifying or restricting those words; that is how this Court shall read section 1110.

II. Lease Extensions and Renewals

Essentially, the Debtors extend the argument asserted in the Sale-Leasebacks issue to whether section 1110 applies to lease extensions and renewals. In each of these transactions, the Debtors had previously entered into leases with respect to covered equipment. Subsequently, at the end of the original lease term, new leases were negotiated or the existing leases were extended. As articulated above, the application of section 1110 should not be restricted to leases which assist in the Debtor's new acquisition of equipment; section 1110 similarly applies to lease extensions and renewals.

III. Leases with Debtors Not Operating Under a Certificate of Convenience and Necessity

Certain parties entered into transactions with Express, which at the time of the transaction was not operating under a Certificate but which subsequently, and prior to the bankruptcy filing, was certified. Other parties entered into transactions with Pan Am Corporation, a holding company that directly or indirectly owns all of the issued and outstanding stock of the other Debtors, which has never been certified. Pan Am Corporation in turn subleased the Aircraft and Equipment to one of its affiliated certified Debtors.

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6 Courts are not alone in their conflicting interpretations of section 1110, commentators also differ. *Compare*, Giddens and Schick, *Section 1110 of the Bankruptcy Code: Time for Refueling?*, 64 Am. Bankr. L.J. 109, 128 (1990) (wherein the commentators concluded that section 1110 applies to the financing of newly acquired equipment.); *with*, Gerstell and Patrinos, *Aviation Financing Problems Under Section 1110 of the Bankruptcy Code*, 61 Am. Bankr. L.J. 1, 25-6 (1987) (wherein the commentators concluded that section 1110 should apply to all leases across the board).

Section 1110 applies to transactions with an "air carrier operating under a certificate of convenience and necessity issued by the Civil Aeronautics Board." 11 U.S.C. § 1110. While the statutory language does not clearly require that a debtor be certified at the time the transaction was entered into, to rule otherwise would lead to incongruous results. For example, if on the eve of filing for bankruptcy an air carrier became certified, such a reading would permit a creditor who had entered into a transaction with a non-certified air carrier several years prior to the bankruptcy to gain the benefits of section 1110. This would surely be an unexpected windfall to those persons who entered into transactions with air carriers that were not certified as of the completion of the transaction. Therefore, lessors who knowingly entered into lease agreements with Express, prior to its certification, assumed the risk of not enjoying section 1110 status. The status of these parties will not be elevated because of Express' subsequent certification.

Unfortunately, some creditors claim to have entered into transactions with Express with the understanding of future certification. While this Court is sympathetic to those creditors' plight, it was never clear that subsequent certification would provide them with the section 1110 status they now seek. They assumed a calculated risk and have lost.

Parties who entered into transactions with Pan Am Corporation find themselves in an even worse position. Pan Am Corporation is not even an air carrier, let alone one operating under a Certificate. Section 1110 speaks of a debtor that is a certified air carrier. Nothing in the section nor its legislative history makes reference to transactions with affiliated debtors that are not certified air carriers which in turn sublease to a debtor that is a certified air carrier. To extend protection to these transactions would violate the language of section 1110. Moreover, Pan Am Corporation is a corporate entity separate and apart from its affiliated Debtors. Had these lessors wanted and intended to fall within section 1110's net of protection, they should have negotiated directly with the certified debtor.

IV. Purchase Money Equipment Security Interest Transactions

General Electric Capital Corporation ("GECC") and United Technologies ("UT") allegedly are holders of PMESIs in aircraft and/or equipment of Pan American World Airways, Inc. ("Pan Am"). Pan Am alleges that its transactions with GECC and UT did not create proper PMESIs, and therefore, GECC and UT are not entitled to the benefits of section 1110 of the Code. UT has not filed either an objection or response to the Debtors' motion to treat UT's interest as other than a PMESI (a non-PMESI), and therefore, UT will not be discussed.[7]

A. Pertinent Facts

In 1985, GECC entered into a loan agreement with Pan Am which provided that Pan Am would apply the aggregate loan proceeds towards the purchase from GECC of 5 aircraft and 20 engines (the "Collateral"). The loan proceeds were also used for modification of the aircraft. The 1985 agreement was memorialized in a promissory note, security agreement and chattel mortgage. The instruments granted to GECC a security interest in the Collateral. However, the loan was not a "one-to-one" transaction; the loan was also secured by additional Aircraft and Equipment already owned by Pan Am. The additional Aircraft and Equipment were included allegedly to induce GECC to enter into the loan agreement. Further, there were certain antecedent non-purchase money obligations between Pan Am and GECC (and GECC's parent) from 1981 which were worked-into the 1985 transaction so that the 1985 Collateral would also act as security for the 1981 obligations.

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7 The Debtors and UT had apparently reached an agreement in principle. However, UT did file a response to the objection of the Creditors Committee to UT's § 1110 status. At the § 1110 hearing, this Court approved the agreement between the Debtors and UT over the objection of the Creditors Committee. *See* Transcript of March 7, 1991 Hearing at 44-55.

In 1987, GECC extended an additional loan to Pan Am. The 1987 loan agreement provided that the 1985 Collateral, in addition to other collateral, would act as security for the 1987 loan. The 1987 loan was a general purpose loan and was not designed to finance the acquisition of any aircraft or equipment. Neither the 1981 nor the 1987 loan is a PMESI, and GECC admits this. Thus, this Court must focus on the 1985 loan.

B. Pan Am's Argument

Pan Am relies on the general rule of purchase money security interests which states: "if collateral secures debt other than its own price, it is *not* a PMSI." *In re Ionosphere Clubs, Inc.*, 112 B.R. 78, 83 (Bankr.S.D.N.Y. 1990) ("*In re Ionosphere Clubs*"). Thus, the traditional PMESI is *not* created if the lien secures pre-existing debt (like the 1981 loan), the loan was not advanced solely to acquire the collateral (the 1985 aircraft modifications), or additional pre-existing collateral is added to the transaction as additional security or inducement for the lender (the 1985 loan). *See e.g.*, *Roberts Furniture Co. v. Pierce (In re Manuel)*, 507 F.2d 990, 993 (5th Cir. 1975); *Southtrust Bank v. Borg-Warner Acceptance Corp.*, 760 F.2d 1240, 1243 (11th Cir. 1985); *Booker v. Commercial Credit Corp. (In re Booker)*, 9 B.R. 710, 711 (Bankr. M.D. Ga. 1981).

C. GECC's Argument

GECC relies on a recent decision of the district court wherein Judge Sweet reversed the decision of the bankruptcy court in *In re Ionosphere Clubs*, which confronted a similar issue in the Eastern Airlines bankruptcy. *First Nat'l Bank v. Shugrue (In re Ionosphere Clubs Inc.)*, No. 90 Civ. 4323, slip op. (S.D.N.Y. Jan. 17, 1991) ("*Ionosphere*"). In *Ionosphere*, Judge Sweet explicitly held that where the proceeds of a loan are used to purchase aircraft and equipment, and the aircraft and equipment also secure other indebtedness, the lender has

a PMESI with respect to the identifiable amount of such loan. *Ionosphere*, slip op. at 10, 16.

D. Discussion

Pan Am and GECC read *Ionosphere* differently. Since *Ionosphere* is a recent case from our district which appears to be on point, this Court will analyze and compare the district court's opinion in *Ionosphere* with the case at hand.[8]

In *Ionosphere*, several lenders (the "Airbus Lenders") made loans in 1978 and 1981 (the "Airbus Loans"), under an indenture established in 1963, to Eastern Airlines to finance the acquisition of certain aircraft (the "Aircraft"). When purchased, the Aircraft became part of a "floating collateral pool" which was established by the indenture and consisted of aircraft, engines and parts owned from time to time by Eastern. The actual property in the pool changed over time as old property was removed from the pool and new property was added. The indenture permitted future advances from lenders and had after-acquired property clauses. All of the loans subject to the indenture were equally and ratably secured by the collateral pool. Consequently, the Aircraft secured debt other than their purchase price, and the Airbus Loans were secured by collateral other than the Aircraft. Moreover, the Airbus Lenders did not have a specific lien on the Aircraft. Rather, under the terms of the indenture, the Airbus Lenders had at any given time an equal and ratable claim on the collateral pool as it existed at the time, and the actual lien on the collateral pool was held by the indenture trustee. If Eastern removed any aircraft from the collateral pool (by sale or otherwise), it was immediately required to prepay the outstanding amount of the note associated with that aircraft.

When Eastern filed for bankruptcy protection, the Airbus Lenders claimed to have the protection of section 1110 as holders of PMESIs in the Aircraft. The bankruptcy court

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8 The following discussion of facts is taken from pp. 3-6 of the *Ionosphere* slip opinion.

found that the security interest of the Airbus Lenders was not a PMESI because the Aircraft not only secured airbus loans, but also the antecedent debts owed to the other lenders with interest in the collateral pool. *In re Ionosphere Clubs*, 112 B.R. at 83-88. This determination was based on the general rule of PMESIs, i.e., if the collateral secures more than its own purchase debt it is not a PMSI. *Id.*

In reversing the bankruptcy court decision, Judge Sweet rejected the "transformation rule" and adopted the "dual status" rule. *Ionosphere*, slip op. at 11-16. The transformation rule examines whether a refinancing, in which purchase money debt is restructured or replaced with new debt, defeats PMSI status for the lien securing the refinancing debt. *In re Ionosphere Clubs*, 112 B.R at 78. The bankruptcy court determined that the Airbus Loans were not PMESIs based on the general PMSI rule, and although it discussed the transformation rule, the bankruptcy court felt it was not necessary to go that far. *Id.* at 84. Judge Sweet explained that the dual status rule is so-called "because it allows a security interest to have both the status of a PMSI to the extent that it is secured by collateral purchased with loan proceeds, and the status of a general security interest, to the extent that the collateral secures obligations unrelated to its purchase." *Ionosphere*, slip op. at 12.

The result of the application of the dual status rule to the Airbus loans was that so long as the creditor was able to determine the outstanding balance of any purchase money indebtedness, that portion would be protected under section 1110. Thus, Judge Sweet followed, and gave strength to, the modern trend which recognizes that only the security interest which secures the non-purchase price debt is not a PMSI, but the interest which secures the purchase price debt retains its PMSI character.[9]

Thus, upon repossession and sale of the collateral, proceeds may only be applied to satisfy the purchase price debt. Any surplus would be returned to the debtor, to be held for the benefit of all creditors who held non-purchase money

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9 The dual status theory is somewhat analogous to claim bifurcation under § 506 of the Code.

security interests in that collateral. When the PMSI exceeds the value of the collateral, the PMSI would cover the entire collateral. *Id.* at 16.

Judge Sweet discussed the problem of the allocation of a loan payment amount to PMSI and non-PMSI interests. *Id.* at 15. In *Ionosphere*, he found no problem of allocation because the differing obligations were owed to different creditors. *Id.* at 16. However, Judge Sweet also discussed the issue of when the debtor has taken multiple loans from a *single* creditor to finance multiple purchases, with each loan secured by security interests in *all* the purchased property (similar to the case, *sub judice*). *Id.* at 14. He concluded that although this situation could be complex, so long as the creditor had a method for determining how much of a PMSI exists in each of the purchased items, the creditor would retain its preferred standing in the collateral. *Id.*

This Court adopts the reasoning set forth by Judge Sweet and follows the *Ionosphere* decision. The lending arrangements relating to the 1985 loan between Pan Am and GECC present, possibly, an even more compelling set of facts for the application of the dual status rule as described in *Ionosphere*.

For example, here, there is no floating collateral pool with multiple lenders that have equal and ratable claims on the pool as a whole. GECC is a lienholder itself; there is no indenture trustee which is the lienholder, as in *Ionosphere*. The 1985 loan instruments do not include any provisions purporting to secure future advances or place liens on after-acquired property. The Court is cognizant that the 1985 loan involved cross-collateralization of pre-existing debt which might not have existed with the Airbus Loans in *Ionosphere*. However, there was pre-existing debt and pre-existing collateral within the *Ionosphere* collateral pool upon which each lender had an equal and ratable lien. Thus, *Ionosphere* is not as distinguishable as the Debtors would suggest.

Ionosphere requires that a creditor be able to determine the outstanding balance of purchase money indebtedness. Here, GECC can easily determine the amount of its PMESI by reference to the 1985 notes GECC is only looking to, and can

only, reclaim the PMESI amount from the 1985 loan, not on any of the cross-collateralization of the previous or subsequent loan transactions. To the extent that there has been payment on the 1985 PMESI notes, the amount of the PMESI is decreased.

Finally, Pan Am claims that the instant case differs from *Ionosphere* in that the Airbus Lenders' collateral consisted of cash collateral, rather than aircraft or equipment.[10] However, it is clear that Judge Sweet's decision did not hinge on this fact. Rather, it appears to be consistent with Judge Sweet's decision that so long as the creditor has a valid PMESI, and is entitled to priority under the Uniform Commercial Code and the Bankruptcy Code, it retains its preferred standing and is able to exercise whatever remedies are provided for in its agreement with the debtor. To the extent that the value of the collateral exceeds the amount of the valid PMESI, the creditor must return the surplus to the debtor. It is of no moment for a debtor to argue that the creditor should not be able to exercise its repossession remedies because the value of collateral far exceeds the amount of a PMESI; that is specifically what the parties bargained for when they entered the PMESI transaction.

In sum, the facts relating to the 1985 loan clearly fall within the realm of Judge Sweet's decision and this Court is persuaded to follow *Ionosphere* and apply the dual status theory. Consequently, *Ionosphere* establishes that GECC's lien on the 1985 aircraft and equipment is a PMESI to the extent that it secures the 1985 purchase money debt, and to that extent, it is protected under section 1110.

V. Equipment Switching/Pooling Arrangements

The Creditors Committee argues that to the extent an alleged lease or PMESI agreement permits interchange or

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10 Eastern had sold the aircraft in dispute pursuant to orders which were without prejudice to the rights of the parties under § 1110 and that the proceeds would be held in escrow and would be deemed equivalent to the aircraft for the purposes of the § 1110 dispute. *Ionosphere*, slip op. at 6.

pooling of aircraft parts and equipment, which would allow for replacement of a lien onto different equipment than that originally provided by the creditor directly, or the equipment provided through the creditor's financing, the transaction falls outside the protection of section 1110. This is so because the claimant thereby releases its rights to the specific, identifiable property originally encumbered. The Committee asserts that the end result of this exercise is a sale.

To the extent that a pooling or interchange agreement relates to an alleged PMESI, this Court follows the decision of Judge Sweet in *Ionosphere*, which permitted such arrangements to retain their PMESI character under the "dual status" rule. The dual status rule applies so long as the PMESI amount and the property to which it relates are identifiable.

As for alleged lease transactions, if under the lease agreement the lessor is permitted to repossess aircraft or equipment, and under the interchange or pooling arrangement the collateral to be repossessed is identifiable and equivalent, despite the fact that it is not the same collateral originally loaned, the arrangement falls within the protection of section 1110.

This determination is necessary because the vast majority of lease transactions in the airline industry include provisions which permit an airline lessee to exchange airframes,[11] engines or other parts through pooling or interchange agreements and to replace equipment which becomes destroyed, worn out, lost or damaged beyond repair with a replacement engine or part of like quality or value. Affidavit of Nils Hallerstrom at ¶ 3; *see also* Memorandum of Creditors Committee at 11, n. 5. The fact that such exchange is permitted by the express terms and conditions of a lease does not transform the lease into something else. The equipment, or its equivalent, must be returned to the lessor at the end of the lease. Therefore, as a policy consideration, this Court is loathe to alter this uniform practice of aircraft leasing developed by those in the industry over many years and currently

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11 In the case of an airframe, title thereto always remains with the lessor, and at the termination of the lease, that particular airframe must be returned to the lessor.

implemented. Thus, provided that at the end of the lease the lessor will have title to, and be entitled to recover, specific, identifiable property, the lease will come within the protection afforded lessors under section 1110. This is so, despite the reality that equipment, engines or parts thereof may not be that which was originally leased. Indeed, in Uniform Commercial Code section 2A-103 a lease is defined as "a transfer of the right to possession and use of goods for a term in return for consideration." U.C.C. § 2A-103(j). There is no requirement that specific, identifiable property be redelivered.[12] The substitution provisions at issue here do nothing more than enable the Debtors to operate the aircraft in the normal course of its business, which unquestionably requires the frequent servicing, and thereby the frequent substitution, of various of each aircraft's parts, including its engines.

VI. True Leases

The Debtors urge that many of the transactions are not leases, but are disguised non-purchase money security interests which are not protected by section 1110. The Debtors assert that the Court must hold an evidentiary hearing on each challenged lease to determine whether it is a true lease or merely a disguised security interest, before the Court can

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12 The Creditors Committee's citation to 5 King, *Collier on Bankruptcy* § 1110.01 at 1110-19 (15th ed. 1990), is misleading. Committee Memo. at 10. The Committee urges that the quote supports its view that interchange destroys the protection of § 1110. The citation in its entirety states:

> Section 1110 does not protect a secured party or lessor unless such secured party or lessor has the right to take possession of the equipment which it financed under the terms of the security agreement, lease or conditional sale contract between the financers and the debtor. *The right to take possession must be explicit in the agreement or contract.*

Id. (emphasis added to portion not included by Committee in their memorandum). There is no suggestion that a right under an agreement to return equivalent property in lieu of the original property will render § 1110 inapplicable. *Collier* merely seeks to emphasize the statutory requirement that the right to take possession must be explicit in the agreement or contract.

permit any repossession under section 1110. However, the Debtors do not specify which transactions are not true leases, but rather list in exhibit "E" those which are proper leases subject to section 1110.

The Debtors and various lease claimants have addressed the true lease issue. Collectively, they set forth the assorted tests for determining whether a transaction in substance is a lease or a security interest (for general loan or sale). For the most part, they rely on the same authorities.

This Court has reviewed the various tests and factors set forth in case law and elsewhere, and discerns that they are collectively similar, if not identical, to the factors set forth in the Uniform Commercial Code.[13] Section 1-201(37) sets forth the relevant inquiries.[14] It is clear to this Court that the mere

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13 Relevant authorities include *Nynex Bisc v. Beker Indus. Corp. (In re Beker Indus. Corp.)*, 69 B.R. 937, 939 (Bankr.S.D.N.Y. 1987); *In re The Answer—The Elegant Large Size Discounter, Inc.*, 115 B.R. 465, 469 (Bankr.S.D.N.Y. 1990); *In re Alpha Creamery Co.*, 4 U.C.C. Rep. Serv. 794, 797-98 (Bankr. W.D. Mich. 1967).

14 Section 1-201(37) states, in part:

> Whether a transaction creates a lease or security interest is determined by the facts of each case; however, a transaction creates a security interest if the consideration the lessee is to pay the lessor for the right to possession and use of the goods is an obligation for the term of the lease not subject to termination by the lessee, and
>
> (a) the original term of the lease is equal to or greater than the remaining economic life of the goods,
>
> (b) the lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods,
>
> (c) the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement, or
>
> (d) the lessee has an option to become the owner of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement.
>
> A transaction does not create a security interest merely because it provides that
>
> (a) the present value of the consideration the lessee is obligated to pay the lessor for the right to possession and use of the goods is substantially equal to or is greater than the fair market value of the goods at the time the lease is entered into,

fact that a transaction is denominated as a lease is not dispositive of the issue. It is evident that a fact-intensive inquiry into each alleged lease is required for such a determination. However, this Court does not have the luxury to do so at this late time.

Our situation is unlike that faced by the court in *Liona Corp. v. PCH Assocs. (In re PCH Assocs.)*, 804 F.2d 193 (2d Cir. 1986), in which the Debtors place great reliance. In *Liona Corp.*, a lease subject to section 365(d) was in issue, and the court had the time to determine whether the transaction was a lease or a security interest, because the court under section 365 can unilaterally extend the time to assume or reject, and is not prohibited from exercising its equitable powers under section 105.

Here, this Court is explicitly prohibited from extending the 60 day period under section 1110 unless the interested parties so agree. The language of section 1110 plainly provides that a lessor's right to take possession remains unaffected "by section 362 or 363 of this title or by any power of the Court to enjoin such taking of possession." 11 U.S.C. § 1110(a). Section 1110 is one of the few provisions in the Code limiting the broad equitable power of this Court codified in section 105(a). Accordingly, if this Court, pursuant to the Debtors' request, engages in fact-intensive evidentiary hearings to determine whether certain leases are true leases before the lessors can exercise their rights under section 1110, the 60 day

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(b) the lessee assumes risk of loss of the goods, or agrees to pay taxes, insurance, filing, recording, or registration fees, or service or maintenance costs with respect to the goods,

(c) the lessee has an option to renew the lease or to become the owner of the goods,

(d) the lessee has an option to renew the lease for a fixed rent that is equal to or greater than the reasonably predictable fair market rent for the use of the goods for the term of the renewal at the time the option is to be performed, or

(e) the lessee has an option to become the owner of the goods for a fixed price that is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed.

period provided in the section will be emasculated. The Debtors could then retain possession of the aircraft and continue to use it well beyond the 60 day period while the lessors remain unpaid. However, the plain language of section 1110 precludes such a result.

In sum, this Court has no authority at this late date to prevent lessors with the right to repossess under their agreement from doing so pursuant to section 1110. However, such parties act at their peril if their alleged leases are not true leases. If a lessor so acts and it is subsequently determined that the transaction was other than a lease protected by section 1110, such party will be responsible for return of the collateral or proceeds, damages, costs etc.. In addition, there would be a violation of the automatic stay, and although sanctions may not be levied under section 362(h), such action would be a violation of this Court's order prohibiting such action against the property of the estate and would be subject to contempt sanctions.

This Court will not issue any "comfort order" to the alleged lessors. If they desire this Court's approval, they may commence an adversary proceeding and file a motion for declaratory judgment that § 1110 applies to their specific transactions with the Debtor, or take whatever steps they deem necessary.

CONCLUSION

In conclusion, this Court holds that: (1) the Sale-Leasebacks are subject to section 1110; (2) lease extensions and renewals are similarly protected; (3) section 1110 only applies to transactions entered into with air carriers that were certified at the time of the transaction; (4) the PMESIs of GECC are protected by section 1110; (5) equipment switching and pooling arrangements in an agreement do not remove the transaction from the protection of section 1110; and, (6) this Court has no authority at this late date to prevent alleged lessors from acting pursuant to section 1110; however, those parties act at their own peril.

Dated: New York, New York
March 15, 1991

/s/ CORNELIUS BLACKSHEAR
Cornelius Blackshear
United States Bankruptcy Judge